

FINANCIAL IMPROVEMENT AND AUDIT READINESS (FIAR) GUIDANCE



UNITED STATES
DEPARTMENT OF DEFENSE



March 2013

OFFICE OF THE UNDER SECRETARY OF DEFENSE
(COMPTROLLER) / CHIEF FINANCIAL OFFICER

Table of Contents

SIGNIFICANT CHANGES	i
EXECUTIVE SUMMARY	iv
Purpose of this Guidance:	iv
1. INTRODUCTION	1
1.A FIAR Priorities and Strategy:	1
1.B Purpose of the FIAR Methodology	2
2. FIAR GOAL, PRIORITIES, AND STRATEGY	5
2.A FIAR Goal.....	5
2.B Priorities	5
2.C Strategy	7
2.D Management Assertion	16
2.E Business Case Analysis.....	18
2.F Integration of FIAR Methodology and OMB Circular A-123, Appendix A Requirements	19
2.G FIAR Strategy Link to the DoD Strategic Management Plan	20
2.H System Transformation Initiatives	21
2.I Roles and Responsibilities	22
3. FIAR METHODOLOGY	24
3.A Methodology – Reporting Entity	24
3.B FIAR Methodology – Service Provider	44
3.C Preparing for an Audit	68
3.D Audit Execution	72
APPENDIX A – MATERIAL REPORTING ENTITIES.....	A-1
APPENDIX B – ROLES AND RESPONSIBILITIES	B-1
APPENDIX C – FIAR STRATEGY DETAILS.....	C-1
APPENDIX D – FIAR METHODOLOGY DETAILS.....	D-1
APPENDIX E – OMB CIRCULAR A-123, APPENDIX A CROSSWALK TO FIAR GUIDANCE	E-1
APPENDIX F – ACRONYM LIST.....	F-1
APPENDIX G – GLOSSARY	G-1

SIGNIFICANT CHANGES

The following table highlights the significant changes and updates that have been made to the guidance since the December 2011 FIAR Guidance. Please note, that the red text¹ in the Methodology graphics and wave-specific risks/**FROs**/KSD tables highlight changes and updates from the December 2011 FIAR Guidance.

SIGNIFICANT CHANGE	REFERENCE
<ul style="list-style-type: none"> Language has been added to explain purpose of FIAR Methodology in detail 	Section 1.B
<ul style="list-style-type: none"> “Key Control Objectives” has been retitled “Financial Reporting Objectives (FROs)”. 	Section 1.B and throughout
<ul style="list-style-type: none"> Language has been added to reflect requirement for the Other Defense Organizations (ODOs) to undergo an examination of individually material assessable units at the ODO-wide level. 	Section 3.D.1
<ul style="list-style-type: none"> Language that management must use to assert audit readiness for an assessable unit has been updated. 	Section 2.D
<ul style="list-style-type: none"> To accelerate the involvement of the Independent Public Accountant (IPA), the FIAR Methodology has been updated to condense the previous 6-phase approach to 5 phases. The audit readiness assertion examination now occurs in Phase 3.0, Assertion/Evaluation. Task-level updates to the FIAR Methodology are as follows: <ul style="list-style-type: none"> Phase 1.0 – Discovery: <ul style="list-style-type: none"> <i>Key Task 1.2, Prioritize</i> – Reporting entities must prepare an assessable unit strategy document which details the approach to achieving audit readiness Phase 2.0 – Corrective Action <ul style="list-style-type: none"> <i>Key Task 2.4, Execute</i> – Reporting entities must perform procedures to verify that corrective action plans have been implemented and that they successfully remediate deficiencies identified during testing (key tasks 1.3 and 1.4) Phase 3.0 – Assertion/Evaluation <ul style="list-style-type: none"> <i>Key Task 3.1, Review</i> – FIAR Directorate reviews reporting entity’s work products against key audit readiness dealbreakers, and determines whether reporting entity can proceed with an examination <i>Key Task 3.2, Engage Auditor</i> – FIAR Directorate engages an IPA or the DoD OIG to perform an examination <i>Key Task 3.3, Assertion Examination</i> – An IPA or the DoD OIG performs examination of Wave 2, 3, or 4 assessable units <i>Key Task 3.4, Address Deficiencies</i> – Reporting entities evaluate the nature and extent of deficiencies noted in the examination report, implement corrective actions, verify that corrective actions remediated deficiencies and then proceed to the Validation Phase Phase 4.0 – Validation <ul style="list-style-type: none"> <i>Key Tasks 4.1 and 4.2, Additional Documentation Review and Determine Audit Readiness</i> – Reporting entities submit additional documentation demonstrating remediation of deficiencies to the FIAR Directorate and DoD OIG for review. FIAR Directorate and the DoD OIG review the examination report and additional documentation demonstrating remediation of deficiencies, and determine whether the reporting entity can proceed to Audit Phase Phase 5.0 – Audit <ul style="list-style-type: none"> Once reporting entities assert audit readiness for the complete SBR, they will undergo audits of current year Statement of Budgetary Resources (SBR) activity (excluding beginning balances) 	Section 3 and throughout
<ul style="list-style-type: none"> Added requirement for reporting entities to identify and evaluation IT General and Application control techniques and activities for any micro-applications and other end-user computing tools (i.e., spreadsheets, databases, etc.) used 	Section 3.A.4

¹ Note that red text may not be legible when printing in black and white.

SIGNIFICANT CHANGE	REFERENCE
<ul style="list-style-type: none"> Added language to reflect requirement for reporting entities to submit assertion documentation to FIAR as they complete Discovery and Corrective Action key tasks and activities, and for FIAR to perform real time reviews of the documentation as it is submitted 	Section 3.C and throughout
<ul style="list-style-type: none"> Key capabilities, capability measures and success criteria have been updated for each wave. 	Wave 1: 2.C.1.1 Wave 2: 2.C.2.1 Wave 3: 2.C.3.1 Wave 4: 2.C.4.1
<ul style="list-style-type: none"> A list of audit “dealbreakers” that have prevented service providers working towards an SSAE No. 16 examination from achieving audit readiness has been included in the Guidance. 	Section 3.B.6, Figure 53
<ul style="list-style-type: none"> Service provider methodology has been updated to include key tasks and activities for service providers electing to forego an SSAE No. 16 examination and focus audit readiness efforts on supporting the reporting entity’s financial statement audit instead. 	Section 3.B. Figures 34-49
<ul style="list-style-type: none"> For the most common Wave 3 assessable units throughout DoD, baseline financial reporting risks and related outcomes have been included in the Guidance. 	Appendix C , Section C.3.2
<ul style="list-style-type: none"> Updated the Management Assertion Template to include reference to the “Schedule”, which appears as Appendix A to the Management Assertion Letter and defines the scope of management’s assertion. 	Section 2.D

Subsequent to the issuance of the February 2013 FIAR Guidance, the FIAR Directorate made further changes to the FIAR Methodology and the role of the FIAR Directorate once management asserts audit readiness. Those changes are highlighted in the table below.

SIGNIFICANT CHANGE	REFERENCE
Described the role of the FIAR Directorate once management has asserted audit readiness. Specifically, the FIAR Directorate approves the scope, tasks and deliverables for the examination of the assertion. The FIAR Directorate will either serve as the Contracting Officer’s Representative (COR) or choose to designate another party.	Section 2.D
<ul style="list-style-type: none"> Updated FIAR Methodology for Reporting Entities as follows: <ul style="list-style-type: none"> Key Task 1.3 Resulting Work Products has been updated <ul style="list-style-type: none"> Key Activity 1.3.2 – added “Control assessments” Key Activity 1.3.4 – changed Resulting Work Product from “Updated control assessments” to “Test results” Key Tasks 3.1 and 3.4 has been renamed to “3.1 Review” and “3.4 Address Deficiencies” respectively <ul style="list-style-type: none"> Detailed Activities for Key Task 3.1 has been updated Key Task 3.3 – combined Key Activities and Detailed Activities Key Task 3.4 – removed “unqualified opinion: proceed to Validation Phase” Key Tasks for Phase 4.0 – Validation has been updated <ul style="list-style-type: none"> Removed key Task 4.1 “Submit Examination Report” and related activities Accordingly, retitled Key Tasks 4.2 and 4.3 as 4.1 “Additional Documentation Review” and 4.2 “Determine Audit Readiness” 	Section 3.A
<ul style="list-style-type: none"> Updated FIAR Methodology for Service Provider as follows: <ul style="list-style-type: none"> Key Activity 1.4.2 – added “Control assessments” as resulting work products Key Activity 1.4.3 – retitled from “Tests of Controls” to “Tests plans” Key Activity 1.4.5 – retitled from “Test Results” to “Updated control assessments” Key Activity 2.2.1 – updated Detailed Activities <ul style="list-style-type: none"> “Corrective actions must be developed for each deficiency identified during execution of tasks 1.4 and 1.5” Renamed Key Tasks 3.1 and 3.4 to “Review” and “Address Deficiencies” respectively <ul style="list-style-type: none"> Detailed Activities for Key Task 3.1 has been updated Key Task 3.3 – added a language to Detailed Activities <ul style="list-style-type: none"> “If unqualified opinion, then proceed to SSAE No.16 Phase” 	Section 3.B

SIGNIFICANT CHANGE	REFERENCE
<ul style="list-style-type: none">– Key Task 3.4 – removed a language from Detailed Activities<ul style="list-style-type: none">o “Unqualified opinion: proceed to Validation Phase”– Updated Phase 4.0 Validation<ul style="list-style-type: none">o Removed Key Task 4.1 “Submit SSAE No. 16 Examination Report”o Accordingly, retitled Key Tasks 4.2 and 4.3 as 4.1 “Additional Documentation Review” and 4.2 “Determine Audit Readiness”	

EXECUTIVE SUMMARY

The Department of Defense (DoD or the Department) is the largest and most complex organization in the world. Each of the Military Departments is larger than most American companies. The Department's annual budget is 56 percent of the Federal Government's discretionary budget and it holds 86 percent of the Federal government's assets, as reported on the Federal Government's Consolidated Financial Statements.

With over \$1 trillion in combined budgetary resources, producing auditable financial statements requires a strategic, long-term plan that addresses issues in an organized, prioritized, and incremental manner.

PURPOSE OF THIS GUIDANCE:

This guidance provides instructions for implementing a consistent, Department-wide plan² for achieving the Department's financial improvement and audit readiness objectives. In accordance with the National Defense Authorization Act (NDAA) for Fiscal Year 2010,

Section 1003, the Financial Improvement and Audit Readiness (FIAR) Directorate developed this guidance for reporting entities and service providers working toward the goal of audit readiness.³

The FIAR Guidance defines the Department's goals, priorities, strategy, and methodology to becoming audit ready. Furthermore, this guidance details the roles and responsibilities of reporting entities and service providers, as well as the processes they should follow to achieve audit readiness.

² This guidance does not have to be used by the following intelligence agencies: National Reconnaissance Office, Defense Intelligence Agency, National Geospatial-Intelligence Agency and National Security Agency. These agencies are following the Office of the Director of National Intelligence (ODNI) guidance.

³ Among the provisions of the legislation is the requirement that the Department "...develop standardized guidance for financial improvement plans by components of the Department."

1. INTRODUCTION

This FIAR Guidance is a handbook that serves as a standard reference guide for existing and new users involved in all audit readiness initiatives across the Department. It will be updated periodically to ensure it remains current with the Department's priorities and aligns with all applicable Federal and Departmental financial management requirements. This update fully incorporates the requirements of the Chief Financial Officer (CFO) Act and OMB A-123, Appendix A, driving efficiency in the integration of the Department's resources to meet the Department's objective of achieving audit readiness by September 30, 2014 (for the SBR General Fund audit) and September 30, 2017 (for the full financial statement audit). This updated guidance supersedes the Department's ICOFR guidance previously issued under the title Fiscal Year 2011 Guidance for Implementing Office of Management and Budget (OMB) Circular A-123, Appendix A: ICOFR, dated October 5, 2010. Any future updates to ICOFR requirements will be included as part of updates to the FIAR Guidance.

1.A FIAR PRIORITIES AND STRATEGY:

The Under Secretary of Defense (Comptroller) (USD(C)) priorities require reporting entities and service providers to focus on improving controls and processes supporting information that is most often used to manage the Department, while continuing to work toward financial, information technology, and supporting documentation improvements that facilitate the achievement of unqualified audit opinions on their financial statements. In support of these objectives, the USD(C) designated two priorities:

- budgetary information, and
- mission critical asset information.

As shown in **Figure 1**, the FIAR Strategy provides a critical path for the Department. The strategy balances the need for short-term accomplishments (Wave 1) against the long-term goal of achieving an unqualified opinion on the Department's financial statements (Wave 4). The FIAR Strategy is consistent with and focuses improvement work on the USD(C) priorities. The first three waves should be performed concurrently because they focus on both of the USD(C)'s priorities, that is, budgetary information and mission critical asset information. Once reporting entities achieve audit readiness for Waves 1, 2 and 3, they should commence Wave 4 audit readiness activities.



Figure 1. FIAR Strategy includes Four Prioritized Waves to Achieve Full Financial Statement Audits

1.B PURPOSE OF THE FIAR METHODOLOGY



The FIAR Methodology defines the key tasks, underlying detailed activities and resulting work products that all reporting entities should follow to become audit ready. The FIAR Methodology maximizes the potential for successful financial statement audits by considering the methods financial statement auditors use to assess financial statement accuracy in accordance with auditing standards (AUs). This guidance draws on the definitions, criteria and requirements that financial statement auditors use to help reporting entities adequately prepare for their first-time financial statement audits. This section of the FIAR Guidance focuses on explaining the concepts of financial statement assertions and Financial Reporting Objectives—and the tests of internal controls and Key Supporting Documents (KSDs) needed to demonstrate audit readiness. Auditors are required to apply professional judgment when determining whether they have obtained sufficient evidence (through tests of internal controls and key supporting documents) to form an opinion on the financial statements. Reporting entity management must perform a similar assessment, to determine whether it has sufficient evidence to demonstrate the organization is audit ready.

Auditing standards codified by the American Institute of Certified Public Accountants (AICPA) define both auditor and management's responsibility during a financial statement audit. By engaging an auditor to perform a financial statement audit, reporting entities are required to make an assertion that the financial statements they prepare are complete and accurate. Specifically, "[i]n representing that the financial statements are fairly presented in conformity with generally accepted accounting principles, management implicitly or explicitly makes assertions regarding the recognition, measurement, presentation, and disclosure of information in the financial statements and related disclosures." [Auditing Standard AU326, Audit Evidence, paragraph.14]

In rendering an opinion on the financial statements taken as a whole, the auditor is required to assess and test transactions and balances summarized in individual line items reported on the financial statements. To accomplish this, the auditing standards require auditors to evaluate all material line items using financial statement assertions. Specifically, AU326 states in paragraph .20 that "the auditor should obtain audit evidence to draw reasonable conclusions on which to base the audit opinion by performing audit procedures to:

- a. Obtain an understanding of the entity and its environment, including its internal control, to assess the risks of material misstatement **at the financial statement and relevant assertion levels** (audit procedures performed for this purpose are referred to as risk assessment procedures);
- b. When necessary, or when the auditor has determined to do so, test the operating effectiveness of controls in preventing or detecting material misstatements **at the relevant assertion level** (audit procedures performed for this purpose are referred to as tests of controls); and
- c. Detect material misstatements **at the relevant assertion level** (audit procedures performed for this purpose are referred to as substantive procedures and include tests of details of classes of transactions, account balances, and disclosures, and substantive analytical procedures)."

As indicated in the bolded text above, auditors are required to start with financial statement line items, and further break the individual line items down to underlying financial statement assertions. While auditors have the discretion to combine or disaggregate financial statement assertions, the five commonly accepted financial statement assertions are existence, completeness, valuation, presentation & disclosure and rights & obligations. **Figure 2** demonstrates an example of how the Appropriations line of the Statement of Budgetary Resources can be broken down into the five financial statement assertions supporting the one line item.

Relationship of Financial Statements, Line Items and Financial Statement Assertions			
Financial Statement			
Statement of Budgetary Resources			
			
Line Item		Financial Statement Assertions	Example Financial Statement Assertion Descriptions
		Existence	All recorded appropriations reported on the SBR exist.
		Completeness	All appropriations received are reported on the SBR.
		Valuation	All appropriations are recorded for the correct amount.
		Presentation & Disclosure	All appropriations are appropriately presented on the SBR and all required disclosures have been made.
		Rights & Obligations	The entity has the rights to all appropriations reported on the SBR.
1290 Appropriations (discretionary and mandatory)			

FIAS G. FY2013. 00

FIAR_G_FY2013_002

Figure 2. Relationship of Financial Statements, Line Items and Financial Statement Assertions

When preparing for audit, reporting entities must fully analyze the financial statement line items included in the scope of its assessable unit, identifying all applicable financial statement assertions relative to the line items. The FIAR Methodology defines the specific steps reporting entities must perform to analyze by financial statement assertion key activities 1.3.1 (for internal controls) and 1.4.3 (for key supporting documents).

Relationship of Financial Reporting Objectives to Financial Statement Assertions

Financial Reporting Objectives⁴

The FIAR Directorate compiled a list of Financial Reporting Objectives (FROs) (mapped to applicable financial statement assertions), to assist reporting entities preparing for audit. FROs are defined as objectives that capture the outcomes needed to achieve proper financial reporting and serve as a point against which the effectiveness of financial controls can be evaluated. In other words, FROs are a further disaggregation of financial statement assertions at the line item level, and provided in the FIAR Guidance to help reporting entities ensure they have appropriately considered and assessed all relevant risks/assertions.

These FROs were obtained from Government Accountability Office's (GAO) *Financial Audit Manual* (FAM) and other GAO reports—and a reference to the source of each FRO is included at the end of each in parenthesis. Utilizing FROs derived from auditor guidance helps reporting entities ensure they have addressed all significant risks and financial statement assertions that will likely be evaluated during financial statement audits.

Relationship of Key Supporting Documentation to Financial Reporting Objectives

To succeed in an audit, reporting entities need to demonstrate they have achieved all FROs relevant to the assessable unit. Reporting entities demonstrate achievement of a FRO through internal control and Key Supporting Document (KSD) testing. Reporting entities, in accordance with the FIAR Methodology, are required to perform both internal control testing (FIAR Methodology key task 1.4) and key supporting documentation testing (FIAR Methodology key task 1.5). It is through the combination of internal controls testing and key supporting document testing that reporting entities will be able to demonstrate achievement of relevant FROs. Reporting entity management must decide how it will demonstrate audit readiness. The reporting entity must rely on internal controls to some extent, but has flexibility with regard to the extent to which it relies on internal controls to achieve FROs.

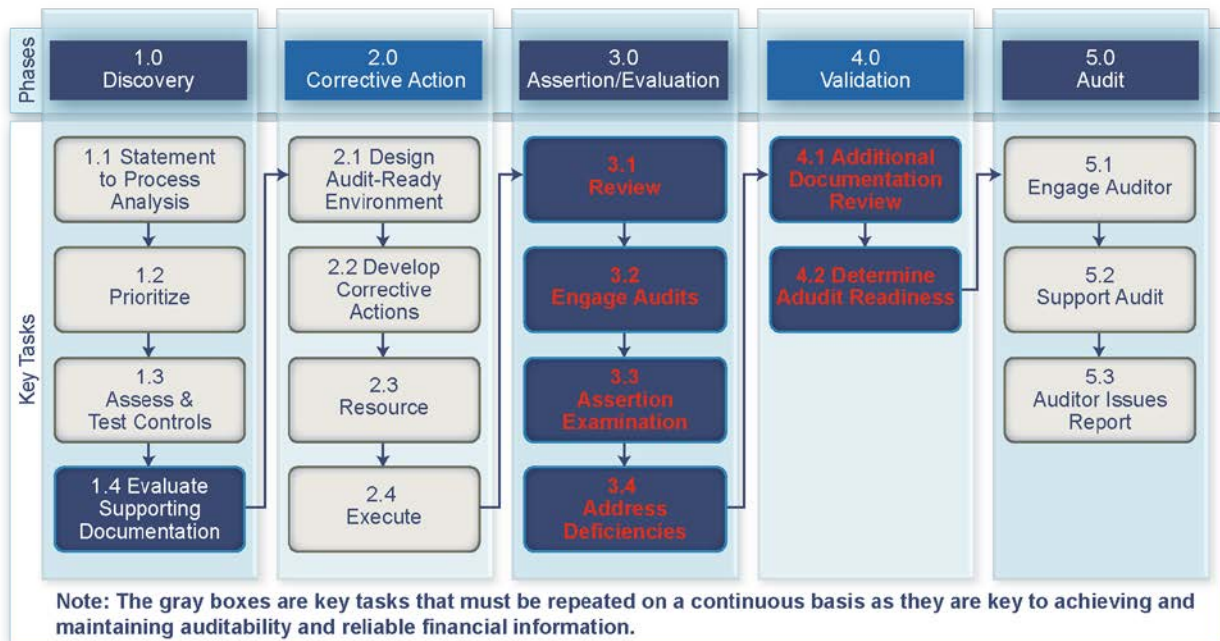
In general, areas with large transaction volumes or numerous individual assets (e.g., supply, contracts, Fund Balance with Treasury (FBWT), Inventory, Operating Material & Supplies (OM&S), General Equipment (GE), etc.) require management and the auditor to rely more on effective internal controls to provide assurance that balances are properly stated at any given date. Management's determination that

⁴ In the current version of the FIAR Guidance, Key Control Objectives (KCOs) have been renamed as Financial Reporting Objectives (FROs). The details of each objective have not been changed; KCOs have simply been renamed as FROs to better communicate the need for reporting entities to perform a combination of internal control testing AND key supporting documentation testing to demonstrate achievement of the financial statement assertions.

effective controls are not in place to mitigate risk for specific FROs does not necessarily preclude an assertion of audit readiness. For example, management may decide that it is more efficient to rely on supporting documentation and limit internal controls reliance for specific FROs for low volume items, such as satellites. However, for populations with a large number of items or with a high volume of transaction activity, such as OM&S, it is more effective and efficient to place more reliance on internal controls, which requires detailed control documentation, including risk assessments, FROs, and control assessments.

Information Technology General Controls (ITGCs) and application controls must be designed effectively and tested for operating effectiveness in order for management to rely on the automated controls and system generated reports (i.e., KSDs). Supporting documentation testing (i.e., substantive testing) cannot overcome ineffective or missing ITGCs and application controls when transaction evidence is electronic and only maintained within a system, or the key supporting evidence is system generated reports.

Reporting entities should focus their audit readiness efforts on improving their processes, controls, systems and related documentation based on the results of the application of the Methodology. Adherence to the Methodology will also enable the Department to comply with the most relevant laws and regulations that have a direct and material impact on the Department's consolidated financial statements. Any standalone efforts to comply with direct and material laws and regulations affecting the reporting entity's financial statements should be completed after achieving audit readiness. The phases and key tasks of the Methodology can be seen in **Figure 3**.



FIAR G_FY2013_003a

Figure 3. FIAR Methodology Phases and Key Tasks to Achieve Auditability and Reliable Financial Information

2. FIAR GOAL, PRIORITIES, AND STRATEGY

2.A FIAR GOAL

The Financial Improvement and Audit Readiness (FIAR) Goal is to improve the Department's financial management operations, helping provide America's Service men and women with the resources they need to carry out their mission and improving our stewardship of the resources entrusted to us by the taxpayers. Success will be demonstrated through a financial statement audit performed by independent auditors resulting in an unqualified audit opinion on the Department's financial statements.

2.B PRIORITIES

The USD(C) established the current FIAR priorities on August 11, 2009. Before establishing the Department's priorities, the USD(C) coordinated them with the Deputy Secretary of Defense, reporting entities, Department of Defense Office of the Inspector General (DoD OIG), OMB, Government Accountability Office (GAO), and Congress, who approved, endorsed or acknowledged these priorities.

The USD(C) priorities are designed to achieve the FIAR objectives. These priorities are:

- budgetary information, and
- mission critical asset information.

The USD(C) also directed the reporting entities to modify and regularly update their Financial Improvement Plans (FIPs) to achieve these objectives and priorities.

2.B.1 Budgetary Information

The Department's major financial decisions are based on budgetary data (e.g., status of funds received, obligated, and expended). As a result, the first USD(C) priority focuses on process improvements, controls, and systems that produce budgetary information. The starting point for achieving auditable financial statements is the Statement of Budgetary Resources (SBR), specifically the Appropriations (discretionary and mandatory) line item. By focusing improvement efforts on budgetary information and the SBR, the Department will be able to:

- Improve the visibility of budgetary transactions resulting in more effective use of resources;
- Provide for operational efficiencies through more readily available financial information;
- Improve fiscal stewardship (ensures that funds appropriated, expended and recorded are reported accurately, reliably and timely); and
- Improve budget processes and controls (precludes Antideficiency Act violations).

2.B.2 Mission Critical Asset Information

The second priority focuses improvement and audit readiness efforts on information that is essential to the effective management of the Department's mission critical assets. For purposes of this priority, mission critical assets are:

- Military Equipment (ME) (e.g., ships, aircraft, combat vehicles),
- Real Property (RP) (e.g., land, buildings, structures, construction in progress, facilities),
- Inventory (INV) (e.g., rations, supplies, spare parts, fuel),
- Operating Materials and Supplies (OM&S) (e.g., ammunition, munitions, missiles), and
- General Equipment (GE) (e.g., material handling equipment, training equipment, special tooling, and special test equipment).

Financial management information necessary for the management of the Department's mission critical assets is also required to support future financial statement audits. This financial management information includes:

- Individual Item Identifier (e.g., unique item identifier, aircraft tail number, ship number, and real property unique identifier),
- Category/Asset Type (e.g., aircraft – airlift fixed-wing),
- Location (e.g., military installation/organization),
- Operational Status (e.g., active, closed, disposed),
- Item Description (e.g., building headquarters, base library), and
- Controlling/Financial Reporting Organization (e.g., Air Force, Defense Logistics Agency).

This information, as well as other management and financial information, is recorded in official systems of record, which are referred to as "Accountable Property Systems of Record" (APSRs). Ensuring that asset accountability and important management information relevant to mission critical assets is accurately recorded in each reporting entity's APSRs is the objective of this priority. Please see the FIAR Guidance website for the [Existence and Completeness Financial Management Data Fields Definitions and Supporting Documentation requirements](#) document.

Accomplishing this priority will improve important management information about mission critical assets and move the Department closer to achieving financial statement auditability and reliable financial information. The existence and completeness (E&C) of assets are two of the four financial statement assertions that financial statement auditors will test in Wave 3. **Reporting entities must ensure that all assets recorded in their APSRs, general ledgers and financial statements exist (Existence), all of the reporting entities' assets are recorded in their APSRs, general ledgers and financial statements (Completeness), reporting entities have the right to report all assets (Rights) and assets are consistently categorized, summarized and reported period to period (Presentation and Disclosure).** The fifth financial statement assertion, Valuation, will not be addressed until Wave 4.

2.C STRATEGY

Since 2005, when the first FIAR Plan was published, the Department's strategy for achieving improved financial information and auditability has evolved to be more focused, effective, and consistent across the reporting entities. The FIAR Strategy (Strategy) incorporates refinements and remains:

- Incremental and prioritized;
- Guided by a Methodology (Business Rules);
- Integrated with the requirements of OMB Circular A-123, Appendix A;
- Integrated with the implementation of the CFO Act and Federal Financial Management Improvement Act (FFMIA) (DoD FMR Vol.1 Chap 3);
- Integrated with the modernization of business and financial systems;
- Based on decentralized, reporting entity-level execution; and
- Comprehensive by focusing improvements on policies, processes and controls, systems and data, audit evidence, and human capital.

A clear, comprehensive strategy for achieving audit readiness is critical to ensuring that limited resources are assigned effectively to facilitate sustained and measurable progress. The Strategy provides a critical path for the Department, while balancing short-term accomplishments with the long-term goal of achieving an unqualified opinion on the Department's financial statements.

Each of the Department's material financial statement line items is affected by unique and complex accounting and auditing challenges that must be overcome to achieve auditability and reliable financial information. **The Strategy groups and prioritizes the material business processes (that result in activity reported on various financial statement line items) within four waves, and then summarizes the steps each reporting entity must take to address each wave.** The waves and steps are prioritized based on the USD(C) priorities, known challenges, and the related dependencies of financial statements, line items and business processes on one another. The Strategy "waves" representing significant levels of effort and accomplishments are noted on **Figure 4**.



Figure 4. FIAR Strategy includes Four Prioritized Waves to Achieve Full Financial Statement Audits

The Department's Strategy draws from the strengths of several alternative approaches and groups individual end-to-end processes into one or more waves. It provides coverage of all financial statements, while prioritizing and improving information most often used by DoD management and the war fighter. Furthermore, as depicted in **Figure 4**, the four waves will lead to interim audit-ready milestones and ultimately to a full-scope financial statement audit. **Reporting entities must identify and implement a combination of control activities and supporting documentation to demonstrate that the FROs relevant to the subject matter, assertion, or processes (e.g., contract pay) have been achieved. The first three waves should be performed concurrently because they focus on both of the USD(C)'s priorities, budgetary information and mission critical asset information.** Once reporting entities achieve audit readiness for Waves 1, 2 and 3, they should commence Wave 4 audit readiness activities.

Previously, the Strategy included a fifth wave that required a full audit (including the valuation of existing assets). However, based on a business case analysis performed by the Department, all assets will not be subject to the valuation assertion. Refer to section **2.E** for discussion of the business case analysis.

The following sections discuss critical aspects of each wave, including the key capabilities that must be achieved to demonstrate audit readiness and related success criteria and challenges.

2.C.1 Wave 1 – Appropriations Received Audit

Accurate and timely recording of appropriations and other budget activity is critical because it provides the budget authority needed to commit, obligate, and expend funds. Absent accurate and timely budget authority information, the Department's ability to fund its mission and operational requirements could be jeopardized and could affect the Department's ability to defend the Nation and its allies. Inaccurate budget authority information could also result in over obligation and expenditures resulting in Antideficiency Act violations.

Recognizing the importance of budgetary information, on August 11, 2009, the USD(C) established the Department's financial improvement priorities. The goal of one of the priorities is accurate and reliable budgetary information, as validated by an SBR audit.

A key element of the SBR is the appropriations receipt and distribution process, which reflects the current fiscal year's appropriated funds. It also includes apportionment and re-apportionment activity by OMB as well as allotment and some sub-allotment activity. Recognizing the importance of the Department's ability to record properly such funding activity in budget and accounting systems, the USD(C) directed that appropriations received and funds distribution be prepared for audit.

Wave 1 processes and related controls include activities performed to control and record transactions related to: (1) the receipt of the budget ("Appropriations Received"), and (2) the distribution of the budget to the major command level. Once Wave 1 related processes and controls have achieved audit readiness, it will demonstrate to Congress and the public that the Department's annual funding has been accurately recorded, controlled, and allocated, and that the funds have been accurately recorded in its financial statements. Successful achievement of Wave 1 will also instill more congressional confidence in the Department's budget processes and budget requests. The processes in this wave include Budget-to-Report, including Fund Balance with Treasury (FBWT).

Although this assertion covers controls that are in place to prevent over-issuance of budget authority, it does not include controls required to prevent over-obligation of budget authority. Controls to prevent over-obligation of appropriated funds are addressed in Wave 2, SBR Audit, which covers all processes, internal controls, systems and supporting documentation that must be audit ready before the entire SBR can be audited.

The goal of audit readiness is for the reporting entity to design and implement a **combination of control activities and supporting documentation to demonstrate that the FROs relevant to the subject matter, assertion, or processes (e.g., contract pay) have been achieved.**

2.C.1.1 Key Capabilities, Capability Measures, and Success Criteria

KEY CAPABILITIES AND CAPABILITY MEASURES

Reporting entities must achieve key capabilities while working to complete Wave 1. Reaching these key capabilities demonstrates a reporting entity's Appropriations Received audit readiness. The key capabilities are aligned with the capability measures, as shown in **Figure 5**. These measures, based on audit requirements to evaluate internal controls and supporting documentation, are designed to measure reporting entity progress towards achieving these capabilities.

Key Capabilities	Definitions/Capability Measures
1. Identify a complete transaction population which is reconciled to the general ledger and financial statements	Reporting entities must prepare a listing of all transactions for the Appropriations Received assessable unit for the assertion period and demonstrate that the sum of the transactions agrees to the general ledger, trial balance, and/or financial statement balance for the assertion period. For example, for Wave 1, the reporting entity must develop a listing of all funding transactions (recorded in PBAS), document which general ledger accounts make up the sum of the individual funding transactions, and reconcile amounts reported in the general ledger and financial statements to the sum of the individual balances. Furthermore, the reporting entity must document any reconciling items/differences that exist, and be able to explain and correct the differences via appropriate adjusting entries.

Key Capabilities	Definitions/Capability Measures
2. Effective controls over recording Appropriations	<p>Reporting entities must demonstrate that control activities for recording Appropriations were suitably designed and operating effectively to provide reasonable assurance that the FROs in Appendix C were achieved. See Wave 1 FROs in Appendix C, for a complete listing of relevant FROs.</p> <ul style="list-style-type: none"> • % of appropriation financial reporting objectives assessed • % of appropriation control activities determined effective
3. Retain and make available supporting documentation to meet audit standards	<p>Reporting entities must ensure that sufficient, relevant and accurate documentation is readily available for an Appropriations Received audit. See Wave 1 KSDs, in Appendix C, for minimum documentation requirements.</p> <ul style="list-style-type: none"> • % of supporting documentation assessed • % of supporting documentation determined sufficient

Figure 5. Appropriations Received Key Capabilities

SUCCESS CRITERIA

To achieve audit readiness for Appropriations Received, a reporting entity must **demonstrate an effective combination of control activities and supporting documentation** that limits the risk of material misstatements by meeting the FROs defined in Appendix C. Reporting entities must address the following:

- For Financial Reporting Objectives where control activities are used to achieve audit readiness, reporting entities must be able to demonstrate that the control activities were suitably designed and operating effectively to provide reasonable assurance that the FROs in Appendix C were achieved.
- Reporting entities must be able to support account transactions, and balances with sufficient, relevant and accurate audit evidence, defined as KSDs in Appendix C, supplemented with the reporting entity's own documentation requirements.

2.C.1.2 Common Challenges

Each wave contains accounting and auditing challenges that must be resolved for reporting entities to become audit ready. For example, during Wave 1 reporting entities must ensure that:

- They are capable of supporting the completeness of funds distributed to the major commands or equivalent. Reporting entities must demonstrate completeness of funds distribution by reconciling the current year budget authority apportioned and allotted to U.S. Standard General Ledger accounts 4510 and 4610 to the fund distribution system. The reconciliation must identify current year budget authority as an element of the entire balance, which includes beginning balances, reductions for executed funds, and upward/downward adjustments, recorded in these accounts.
- Internal controls and supporting documentation are appropriately evaluated and maintained for all material funds sub-allotted to other DoD organizations (e.g., U.S. Army Corps of Engineers (USACE), Naval Facilities Engineering Command (NAVFAC)).

2.C.2 Wave 2 – SBR Audit

The SBR presents all budgetary resources that a reporting entity has available, the status of those resources at period end, a reconciliation of changes in obligated balances from the beginning to the end of the period, and cash collections and disbursements for the period reported. A Wave 2 SBR audit includes all processes, internal controls, systems and supporting documentation that must be audit ready before the SBR can be audited. Significant processes in this wave include Procure-to-Pay, Hire-to-Retire, Order-to-Cash, and Budget-to-Report, including FBWT.

2.C.2.1 Key Capabilities, Capability Measures, and Success Criteria

KEY CAPABILITIES AND CAPABILITY MEASURES

The FIAR Directorate has defined key capabilities that reporting entities must achieve to complete Wave 2. These are major capabilities that reporting entities must achieve and sustain to demonstrate SBR audit readiness. The key capabilities are aligned with the capability measures, as shown in **Figure 6**. These measures, based on audit requirements to evaluate internal controls and supporting documentation, are designed to measure reporting entity progress in achieving these capabilities.

Key Capabilities	Definitions/Capability Measures
1. Identify a complete transaction population which is reconciled to the general ledger and financial statements	Reporting entities must prepare a listing of transactions for the assessable unit for the assertion period and demonstrate that the sum of the transactions agrees to the general ledger, trial balance, and/or financial statement balance for the assertion period. For example, if a reporting entity is asserting audit readiness of its Reimbursable Work Orders (RWO) for FY 2011, the reporting entity must develop a listing of all RWOs for FY 2011, document which general ledger accounts make up the sum of the individual RWO transactions, and reconcile amounts reported in the general ledger and financial statements to the sum of the individual balances. Furthermore, the reporting entity must document any reconciling items/differences that exist, and be able to explain and correct the differences via appropriate adjusting entries.
2. Effective FBWT transaction-level reconciliations and reporting to Treasury	Reporting entities must demonstrate that control activities for FBWT were suitability designed and operating effectively to provide reasonable assurance that the FROs in Appendix C were achieved. See Wave 2 FBWT FROs Table in Appendix C for a complete listing of relevant FROs. <ul style="list-style-type: none"> • % of FBWT financial reporting objectives assessed • % of FBWT control activities determined effective
3. Effective controls over recording and maintaining obligations	Reporting entities must be able to demonstrate that control activities for recording obligations were suitability designed and operating effectively to provide reasonable assurance that the FROs in Appendix C were achieved. See Wave 2 FRO table in Appendix C for a complete listing of FROs relevant to the obligations incurred. <ul style="list-style-type: none"> • % of obligation financial reporting objectives assessed • % of obligation control activities determined effective
4. Effective controls over recording receipt of goods or services	Reporting entities must be able to demonstrate that control activities for recording receipt of goods or services were suitability designed and operating effectively to provide reasonable assurance that the FROs in Appendix C were achieved. See Wave 2 FRO table in Appendix C for a complete listing of relevant FROs. <ul style="list-style-type: none"> • % of receipt financial reporting objectives assessed • % of receipt control activities determined effective
5. Effective controls over recording disbursements	Reporting entities must be able to demonstrate that control activities for recording disbursements were suitability designed and operating effectively to provide reasonable assurance that the FROs in Appendix C were achieved. See Wave 2 FRO table in Appendix C for a complete listing of FROs relevant to disbursements/outlays. <ul style="list-style-type: none"> • % of disbursement financial reporting objectives assessed • % of disbursement control activities determined effective
6. Retain and make available supporting documentation to meet audit standards	Reporting entities are responsible for ensuring that sufficient, relevant and accurate supporting documentation is readily available for all material line items. See Wave 2 KSD table, in Appendix C, for minimum documentation requirements. <ul style="list-style-type: none"> • % of supporting documents assessed • % of supporting documents determined sufficient (adequately retained and readily available)

Figure 6. SBR Key Capabilities

SUCCESS CRITERIA

To achieve SBR audit readiness, a reporting entity, in coordination with its service provider(s) must **demonstrate an effective combination of control activities and supporting documentation** that limits the risk of material misstatements by meeting the **FROs** defined in **Appendix C**. Reporting entities must address the following:

- For **Financial Reporting Objectives** where control activities are used to achieve audit readiness, reporting entities must be able to demonstrate that the control activities were suitably designed and operating effectively to provide reasonable assurance that the FROs in **Appendix C** were achieved.
- Reporting entities must be able to support account transactions, and balances with sufficient, relevant and accurate audit evidence, defined as KSDs in **Appendix C**, supplemented with the reporting entity's own documentation requirements.

2.C.2.2 Common Challenges

Each wave contains accounting and auditing issues that must be resolved for reporting entities to progress towards audit readiness. For example, during Wave 2 reporting entities must address:

- **Beginning balances for FBWT.** Given the long life of Federal appropriations, reporting entities must keep a minimum of six to 10 years of documentation to support all funding, collections, disbursements, adjustments, and reconciliation activity (note: audit requirements are different from National Archives and Records Administration (NARA) requirements).
- **Complexities surrounding shared Treasury accounts.** Reporting entities sharing Treasury accounts must work with their service provider to ensure that internal controls and supporting documentation are in place to support an SBR audit, especially to ensure suspense account items are assigned to the correct entity.
- **Reconciliation and traceability of interagency agreements, including Military Interdepartmental Purchase Requests (MIPR).** Due to the limited capabilities of existing accounting systems, reporting entities are not always able to capture sufficient trading partner information needed to reconcile intragovernmental transactions and balances. Additionally, some reporting entities have difficulty in tracing recorded interagency agreements back to originating source documentation (e.g., interagency agreement, invoices, receiving reports).
- **Accounts Payable Accruals.** Because goods/services are partially or fully delivered in advance of invoices, reporting entities should design effective accrual processes to ensure that goods or services received are recorded in the SBR in the proper period.
- **Dependencies on service provider(s) processes and controls for efficient and effective execution of its end-to-end business processes.**

As reporting entities continue to work on Wave 2, additional accounting and auditing issues may be identified. Reporting entities should report issues in their FIPs, allowing them to track progress for resolution and assign resources and dependencies based on related key tasks.

2.C.3 Wave 3 – Mission Critical Asset Existence & Completeness (E&C) Audit

Mission Critical Asset E&C audit focuses primarily on the E&C financial statement assertions, but also includes the Rights assertion and portions of the Presentation and Disclosure assertion. That is, **reporting entities must ensure that all assets recorded in their APSR exist (Existence), all of the reporting entities' assets are recorded in their system (Completeness), reporting entities have the right to report all assets (Rights), and assets are consistently categorized, summarized, and reported period to period (Presentation and Disclosure). The asset categories included in this wave include ME, RP, INV, OM&S, and GE.** This will allow the Department and its reporting entities to demonstrate the E&C of its assets before focusing on the reported value of the assets.

2.C.3.1 Key Capabilities, Capability Measures, and Success Criteria

KEY CAPABILITIES AND CAPABILITY MEASURES

The FIAR Directorate has defined key capabilities that reporting entities must achieve to successfully complete Wave 3. These are key capabilities the reporting entities must achieve and sustain to demonstrate E&C audit readiness. The key capabilities are aligned with the capability measures, as shown in **Figure 7**. These measures, based on audit requirements to evaluate internal controls and supporting documentation, are designed to measure reporting entity progress towards achieving these capabilities.

Key Capabilities	Definitions/Capability Measures
1. Identify a complete transaction population which is reconciled to the general ledger and financial statements	Reporting entities must prepare a listing of transactions for the assessable unit for the assertion period and demonstrate that the sum of the transactions agrees to the general ledger, trial balance, and/or financial statement balance for the assertion period. For example, if a reporting entity is asserting audit readiness of its Military Equipment for FY 2011, the reporting entity must complete a reconciliation of the military equipment assets recorded in its APSR to its general ledger and amounts reported in the financial statements. Furthermore, the reporting entity must document any reconciling items/differences that exist, and be able to explain and correct the differences via appropriate adjusting entries.
2. Effective physical inventories that meet audit standards	Reporting entities must design and implement physical inventory count procedures and documentation that will withstand audit scrutiny. See DoDI 4140.1 R, 4000.25-M, 4000.25-2M, 5100.76-M, 4165.14, 5000.64 for the Department's instructions for physical inventory counts. % of assets subject to physical inventory within the required time span
3. Effective controls over recording asset acquisitions, disposals and transfers	Reporting entities must demonstrate that control activities for recording asset acquisitions, disposals, and transfers were suitability designed and operating effectively to provide reasonable assurance that the FROs in Appendix C were achieved. Adjustments to physical inventory counts are an indication of the effectiveness of controls over recording acquisitions, disposals, and transfers of assets. % of physical inventory adjustments
4. Retain and make available supporting documentation to meet audit standards	Reporting entities must ensure that sufficient, relevant and accurate supporting documentation is readily available for an E&C audit. See Wave 3 KSD table, in Appendix C, for minimum documentation requirements. <ul style="list-style-type: none"> % of supporting documents assessed % of supporting documents determined sufficient (adequately retained and readily available)
5. Effective controls over financial and management data in the Accountable Property Systems of Record	Reporting entities must ensure the sufficiency and accuracy of Financial and Management data in preparation for an E&C audit. See Wave 3 Financial Management Data Table in Appendix C for minimum data fields validation requirements. # of data fields blank out of total data fields
6. Effective processes, controls and system improvements	Reporting entities must design and implement corrective actions to remediate weaknesses in processes, internal controls, and supporting financial related systems. <ul style="list-style-type: none"> % of corrective actions complete (per FIPs) % of assessable units validated

Figure 7. Wave 3 Key Capabilities

SUCCESS CRITERIA

To achieve E&C audit readiness, a reporting entity, in coordination with its service provider(s) must **demonstrate an effective combination of control activities and supporting documentation** that limits the risk of material misstatements by meeting the **FROs** defined in Appendix C. Reporting entities must address the following:

- For **Financial Reporting Objectives** where control activities are used to achieve audit readiness, reporting entities must be able to demonstrate that the control activities were suitability designed and operating effectively to provide reasonable assurance that the FROs in Appendix C were achieved.
- Reporting entities must be able to support account transactions, and balances with sufficient, relevant and accurate audit evidence, defined as KSDs in Appendix C, supplemented with the reporting entity's own documentation requirements.

2.C.3.2 Common Challenges

Each wave is subject to accounting and auditing issues that must be resolved to progress towards audit readiness. For example, during Wave 3 reporting entities must address:

- **Units of Measure** – Implementing standard definitions for units of inventory and assets to ensure that item counts are accurate (e.g., will airframes be separately counted from engines or the two items together comprise one asset record within the APSR?).
- **Rights to Assets** – Work with leading OSD offices to implement business rules around co-located facilities (joint basing) and assets purchased by others (e.g., USMC aircraft).
- **Reworked Assets** – Implement a standard and consistent method for tracking and reporting assets that are removed from a larger asset, reworked or otherwise modified and then integrated into a different asset (e.g., aircraft engines).
- **Physically Isolated Assets** – Implement techniques and methods for demonstrating the existence of assets that are not easily inspected (e.g., assets located in space or underwater).
- **Dependencies on service provider(s) processes and controls** for efficient and effective execution of its end-to-end business processes.

2.C.4 Wave 4 – Full Audit Except for Existing Asset Valuation

Assertions for this wave include all material reporting entity line items, account balances and financial transactions impacting the Balance Sheet, Statement of Net Cost, and Statement of Net Position not covered by Waves 2 or 3 (e.g., Environmental and Disposal Liability). The FIAR priorities require reporting entities to devote their resources and efforts towards completing Waves 1 through 3 before beginning work on Wave 4. Nevertheless, much of the work to complete Waves 1 through 3 impacts the requirements and objectives for Wave 4. For example, the following interdependencies will be leveraged to accelerate progress in Wave 4:

- **Delivered Orders**, reported on the SBR (covered in Wave 2), equate to a portion of Accounts Payable reported on the Balance Sheet
- **Spending Authority from Offsetting Collections**, reported on the SBR (covered in Wave 2), includes some of the amounts reported in Accounts Receivable –Intragovernmental on the Balance Sheet
- **Unobligated Balances and Unpaid Obligations**, reported on the SBR (covered in Wave 2), correlate to FBWT reported on the Balance Sheet
- **Obligations Incurred**, reported on the SBR (covered in Wave 2), equates to a substantial portion of Gross Costs reported on the Statement of Net Cost.

In addition, this wave adds the valuation assertion for assets (i.e., ME, RP, GE, INV, and OM&S). One significant and potentially very costly challenge in Wave 4 is obtaining auditable values for the significant amount of existing DoD assets located worldwide and procured many years ago, well before passage of the CFO Act and other legislation mandating auditability. As required by Congress, the Department performed a business case analysis, examining various options for valuing and reporting assets on DoD financial statements. The business case concluded that the cost to obtain such information would not be justified by the value of obtaining such information. Therefore, the Department has determined that existing assets will not be subject to the valuation assertion. Refer to 2.E for additional details regarding the business case.

2.C.4.1 Key Capabilities, Capability Measures, and Success Criteria

KEY CAPABILITIES AND CAPABILITY MEASURES

Reporting entities must track and achieve the following key capabilities while working to complete Wave 4. These major capabilities demonstrate a reporting entity's full-scope audit readiness, with the exception of existing asset valuation. The key capabilities are aligned with the capability measures, as shown in **Figure 8**. These measures will be based on audit requirements to evaluate internal controls and supporting documentation and will be designed to measure reporting entity progress towards achieving these capabilities.

Key Capabilities	Definitions/Capability Measures
1. Identify a complete transaction population which is reconciled to the general ledger and financial statements	Reporting entities must prepare a listing of transactions for the assessable unit for the assertion period and demonstrate that the sum of the transactions agrees to the general ledger, trial balance, and/or financial statement balance for the assertion period. For example, if a reporting entity is asserting audit readiness of its Environmental and Disposal Liabilities line item, the reporting entity must extract a detail listing of all Environmental and Disposal Liabilities balances as of the end of FY 2011, document which general ledger accounts make up the sum of these balances, and reconcile amounts reported in the general ledger and financial statements to the sum of the individual balances. Furthermore, the reporting entity must document any reconciling items/differences that exist, and be able to explain and correct the differences via appropriate adjusting entries.
2. All capabilities from Waves 1 through 3 have been met.	Reporting entities must demonstrate an effective combination of control activities and supporting documentation to demonstrate that the FROs for Waves 1 through 3 have been achieved. See FRO tables in Appendix C for a complete listing of FROs relevant to Waves 1, 2 and 3.
3. To manage, account for, and report Investments	Reporting entities must demonstrate an effective combination of control activities and supporting documentation to meet the FROs related to investments. See Wave 4 FRO table in Appendix C for a complete listing of relevant FROs . <ul style="list-style-type: none"> • % of investment financial reporting objectives assessed • % of investment control activities determined effective
4. To correctly value, maintain accountability, and report all new acquisitions of non-existing Inventory and Related Property, and Property, Plant and Equipment (PP&E)	Reporting entities must demonstrate an effective combination of control activities and supporting documentation to meet the FROs for valuation of new acquisitions of non-existing inventory and related property , and PP&E. See Wave 4 FRO table in Appendix C for a complete listing of relevant FROs . <ul style="list-style-type: none"> • % of asset category financial reporting objectives assessed • % of asset category control activities determined effective
5. To effectively manage, estimate, classify, and report Military Retirement and other Federal Employee Benefits	Reporting entities must demonstrate an effective combination of control activities and supporting documentation to meet the FROs related to military health benefits actuarial accruals . See Wave 4 FRO table in Appendix C for a complete listing of relevant FROs . <ul style="list-style-type: none"> • % of military retirement health benefit financial reporting objectives assessed • % of military retirement health benefit control activities determined effective
6. To accurately estimate, disburse and report Environmental Liabilities	Reporting entities must demonstrate an effective combination of control activities and supporting documentation to meet the FROs related to environmental liabilities . See Wave 4 FRO table in Appendix C for a complete listing of relevant FROs . <ul style="list-style-type: none"> • % of environmental liability financial reporting objectives assessed • % of environmental liability control activities determined effective
7. To correctly estimate, record, and report Advances from Others, Accrued Unfunded Annual Leave and/or Contingent Liabilities	Reporting entities must demonstrate an effective combination of control activities and supporting documentation to meet the FROs related to Advances from Others, Accrued Unfunded Annual Leave and/or Contingent Liabilities . See Wave 4 FRO table in Appendix C for a complete listing of relevant FROs . <ul style="list-style-type: none"> • % of accrued liability control objectives assessed • % of accrued liability control activities determined effective
8. To correctly record, classify and report Non-Exchange Revenue	Reporting entities must demonstrate an effective combination of control activities and supporting documentation to meet the FROs related to Exchange Revenue . See Wave 4 FRO table in Appendix C for a complete listing of relevant FROs . <ul style="list-style-type: none"> • % of non-exchange revenue financial reporting objectives assessed • % of non-exchange revenue control activities determined effective

Key Capabilities	Definitions/Capability Measures
9. To correctly record, classify and report Imputed Financing	<p>Reporting entities must demonstrate an effective combination of control activities and supporting documentation to meet the FROs related to Imputed Financing. See Wave 4 FRO table in Appendix C for a complete listing of relevant FROs.</p> <ul style="list-style-type: none"> • % of imputed financing financial reporting objectives assessed • % of imputed financing control activities determined effective
10. To correctly calculate, record, and report Depreciation Expense	<p>Reporting entities must demonstrate an effective combination of control activities and supporting documentation to meet the FROs related to Depreciation Expense. See Wave 4 FRO table in Appendix C for a complete listing of relevant FROs.</p> <ul style="list-style-type: none"> • % of depreciation expense financial reporting objectives assessed • % of depreciation expense control activities determined effective
11. To retain and make readily available supporting documentation to meet audit standards	<p>Reporting entities are responsible for ensuring that sufficient, relevant and accurate supporting documentation is readily available for all material line items. See Wave 4, KSD table in Appendix C, for minimum documentation requirements.</p> <ul style="list-style-type: none"> • % of supporting documents assessed • % of supporting documents determined sufficient (adequately retained and readily available)

Figure 8. Key Capabilities for Wave 4

SUCCESS CRITERIA

To achieve audit readiness for Wave 4, a reporting entity must **demonstrate an effective combination of control activities and supporting documentation** that limits the risk of material misstatements by meeting the **FROs** defined in **Appendix C**. Reporting entities must address the following:

- For **Financial Reporting Objectives** where control activities are used to achieve audit readiness, reporting entities must be able to demonstrate that the control activities were suitability designed and operating effectively to provide reasonable assurance that the **FROs** in **Appendix C** were achieved.
- Reporting entities must be able to support account transactions, and balances with sufficient, relevant and accurate audit evidence, defined as **KSDs** in **Appendix C**, supplemented with the reporting entity's own documentation requirements.

2.C.4.2 Common Challenges

Historical acquisition costs for existing assets will not be audited in Wave 4; however, reporting entities must have the capability to properly value and report new asset acquisitions. This capability is one of the more difficult challenges in Wave 4, since it requires the implementation of new acquisition processes, and controls impacting contract structure for cost accumulation. This work has been ongoing for years and began with the change to the Federal accounting standard affecting the reporting of ME (e.g., ships, aircraft, and combat vehicles). Prior to this standard change in 2003, the standards permitted the expensing of ME assets.

Other challenges that must be addressed in coordination with leading OSD offices are:

- **Valuing reworked PP&E.**
- **Establishing an infrastructure to support a full-scope financial statement audit. This will be important to ensure that resources are available to support auditor requests for information and support and resolve audit issues that arise during the course of the audit.**

To ensure consistency, OSD will provide guidance when these types of issues are identified.

Details about the scope, risks, **FROs**, **KSDs**, and audit execution of each wave are included in **Appendix C**.

2.D MANAGEMENT ASSERTION

Once a reporting entity finishes corrective actions for its audit readiness efforts, the reporting entity must prepare an assertion declaring that the subject matter (assessable unit) is audit ready. See section 3.A.3 for the definition of assessable unit. Management's assertion is a written declaration that the subject matter (assessable unit) is audit ready in conformity with the internal control and supporting documentation criteria (included in the following "Management Assertion Template"), which are based upon the Methodology.

If Management is asserting audit readiness of something other than a financial statement line item, Management must define the subject matter of the assertion (assessable unit) by clearly identifying the beginning/initiation and end of the process. Note that the criteria is suitable for examinations of management assertions of audit readiness, but not for audits of financial statements (or financial statement line item balances), in accordance with auditing standards.

Additionally, if the assertion is something other than a financial statement line item, Management must prepare a schedule to identify the financial activity/balances that are the subject matter of the assertion. Because something less than a financial statement (or line item) is being asserted, this schedule must reconcile the activity/balances asserted to general ledger(s), allowing the auditor to render an audit readiness opinion on the specific assessable unit asserted. The IPA will determine the nature, extent, and the timing necessary to render an opinion.

Once Management prepares the assertion, the FIAR Directorate must approve the scope, tasks, and deliverables for the examination of the assertion. Upon approval of the examination, the FIAR Directorate or Component will engage an auditor. If the auditor is an independent public accounting firm, the FIAR Directorate will either serve as the Contracting Officer's Representative (COR) or choose to designate another party as the COR to ensure the examination scope and procedures meet the full intent of the audit readiness examinations and the audited entity is not overseeing the auditor.

The IPA will perform test of internal controls and supporting documentation, against audit readiness criteria, to support their examination opinion. Management will be required to support its assertion with adequate documentation to demonstrate that it has adequate and effective internal controls and supporting documentation to achieve audit readiness. Management's audit readiness testing and the practitioner's examination testing to assess audit readiness are both less rigorous than testing that will be required under a financial statement audit. Therefore, management must accept the implications of sampling risk and understand that its test results will be assessed in light of more rigorous audit testing when the subject matter (assessable unit) is subject to a financial statement audit. Refer to **Appendix D** for guidance on control and supporting documentation testing to support audit readiness.

Management must prepare its assertion related to the subject matter (assessable unit) and provide the following assertion template to the practitioner, who will perform an examination on this assertion and report its opinion in the *Assertion/Evaluation Phase*.

Management Assertion Template

Management of the [Component] is responsible for preparing the [Schedule depicting activity for the Assessable Unit⁵], for the [period], for the [name of the Assessable Unit] as presented in Appendix A (the Schedule) and for the design, implementation, and operating effectiveness of the controls over the preparation of the Schedule in accordance with the U.S. Department of Defense (DoD) FIAR Guidance, dated March 2013 (DoD FIAR Guidance).

The [Component] asserts that the Schedule is audit ready as defined by the [Component] having control activities and supporting documentation in accordance with the following criteria based on the DoD FIAR Guidance dated March 2013:⁶

1. Internal Control Criteria. The component has identified the minimum control activities needed to achieve audit readiness, and can demonstrate that the control activities were suitably designed and operating effectively to provide reasonable assurance that the Financial Reporting Objectives (FROs) in Appendix B were achieved. Specifically:
 - a. Control activities related to the activity presented in the Schedule are suitably designed and implemented to provide reasonable assurance that the FROs presented in Appendix B were achieved, if these controls were operating as designed.
 - b. Documentation relevant to control activities is available for review as measured by the capability to provide requested documentation to the practitioners with sufficient time for the practitioners to test the documentation, prepare and review work papers, and prepare and issue their report by the deadlines.
 - c. Control activities related to the activity presented in the Schedules were operating effectively, in accordance with sample sizes and acceptable deviations described in the DoD FIAR guidance, to provide reasonable assurance that the FROs were achieved.
2. Supporting Documentation Criteria. The Component demonstrates that FROs related to activity/balances presented in the schedule are reasonably achieved by demonstrating the activity/balances are supported by transaction details and sufficient supporting documentation; defined as Key Supporting Documents (KSDs) in Appendix C. Specifically:
 - a. KSDs identified in Appendix C relevant to the Schedule are readily available for review as measured by the capability to provide requested documentation to the practitioners with sufficient time for the practitioners to test the documentation, prepare and review work papers, and prepare and issue their report by the deadlines.
 - b. KSDs demonstrate that account balances and transactions are accurately recorded in the Schedule at the correct dollar amount and in the correct accounting period, appropriation, and general ledger account as applicable, in accordance with the sample sizes and acceptable deviations described in the DoD FIAR guidance.

[Component Name]

[Name / Title]

⁵ The schedule is an important component of the audit readiness assertion and examination to clearly define the scope of the assertion and demonstrate the ability to tie transaction details to general ledger balances. The examination will not provide an opinion on whether the balances are fairly stated in accordance with GAAP; rather it will provide an assessment of whether the Component processes and supporting documentation underlying the schedule meet the FIAR Guidance definition of audit readiness.

⁶ ii The schedule must be adapted to capture the activity relevant to the Assessable Unit. Examples:

- MDAP examinations have used the 1002 to depict the results of MDAP activity,
- Civilian pay would use the balances and activity in the 4800/4900 accounts related to civilian pay,
- Financial Reporting would use a schedule depicting the reconciliation of unadjusted general ledger balances to adjusted balances to the financial statements.

2.E BUSINESS CASE ANALYSIS

Developed in 2011, the *Business Case Analysis (BCA) of Alternatives for Valuing Mission Critical Assets* (BCA) was required by the FY 2011 National Defense Authorization Act (NDAA), which states:

“...the Under Secretary of Defense (Comptroller) shall...examine the costs and benefits of alternatives for valuing Department of Defense assets and select an approach to such valuation that is consistent with principles of sound financial management and the conservation of taxpayer resources.”

Since the Department is focused on reducing its annual operating budget, as directed by the Secretary of Defense, the NDAA requirement to conduct the BCA provided DoD the opportunity to select an approach to not only resolve this long-standing valuation obstacle to achieving auditability and reliable financial information, but to do so in such a way that is cost effective to conserve DoD and taxpayer resources.

The BCA considered and incorporated the following assumptions:

- The DoD will maintain its current strategy to achieve auditability in waves starting with the priorities of the Statement of Budgetary Resources (SBR) and validating the existence and completeness of mission critical assets, and only after achieving those priorities will the Department begin to value assets for Balance Sheet reporting. Given this assumption, this BCA only looks at the incremental cost to record and audit asset values in an improved reporting environment that results from changes to business and financial processes, and controls and systems needed to achieve the objectives of the SBR and mission critical asset existence and completeness priorities.
- The Enterprise Resource Planning (ERP) systems will provide the capability to accurately and timely record business events and financial transactions and post them to DoD accounting ledgers.
- DoD produces audited financial statements for users outside the Department, and the primary purpose of government financial statements is to demonstrate effective stewardship and management of public funds to citizens.

Impact of the Business Case Analysis on the FIAR Audit Readiness Strategy

The Business Case concluded that it was not cost effective to value existing assets; therefore, Wave 5 has been eliminated. **However, each entity asserting audit readiness must establish a date for each class of PP&E, Inventory, and Operating Materials & Supplies for which it can provide sufficient evidence to support recorded transactions.** For example, one entity may have reengineered its real property business processes and established effective controls for recording transactions in fiscal year 2006. Another entity may not have established effective business process and controls for real property until fiscal year 2010. The first entity could assert that its real property transactions are supportable beginning in fiscal years 2006, the second in fiscal year 2010. Therefore, assertions about the date at which transactions become auditable will vary by reporting entity and asset class.

From the standpoint of an audit opinion, the further back an entity can assert the quicker the existing assets become immaterial to the reported balances. A basic assumption associated with not valuing existing assets is that over time the net book value of such assets becomes immaterial to the reported balances. A second assumption is that the cost of valuing assets acquired before effective processes (existing assets) and controls were implemented is not justified by the value of such information.

2.F INTEGRATION OF FIAR METHODOLOGY AND OMB CIRCULAR A-123, APPENDIX A REQUIREMENTS

The December 2011 FIAR Guidance update fully merged OMB Circular A-123, Appendix A requirements into the FIAR Methodology, resulting in compliance with both the CFO Act and OMB A-123, Appendix A. This integration drives efficiency in the utilization of the Department's resources to meet the objective of achieving an audit ready state, as the objectives, key tasks and activities and resulting work products of the two initiatives are essentially the same.

Reporting entities must submit interim work products (e.g., process flowcharts and narratives, risk assessments, test plans, etc.) to the FIAR Directorate upon completion of the key tasks and activities in the Discovery and Corrective Action phases and in accordance with their FIP milestone dates. **The FIAR Directorate will review all work products as they are submitted by the reporting entities.** This ongoing review will allow the FIAR Directorate to monitor the Department's progress and provide the reporting entities with feedback prior to submission of their final "audit ready" assertion documentation.

2.F.1 Additional Reporting Requirements

All reporting entities must follow the FIAR Methodology, to include completing key tasks, activities, and work products. In addition, each DoD reporting entity must submit the following:

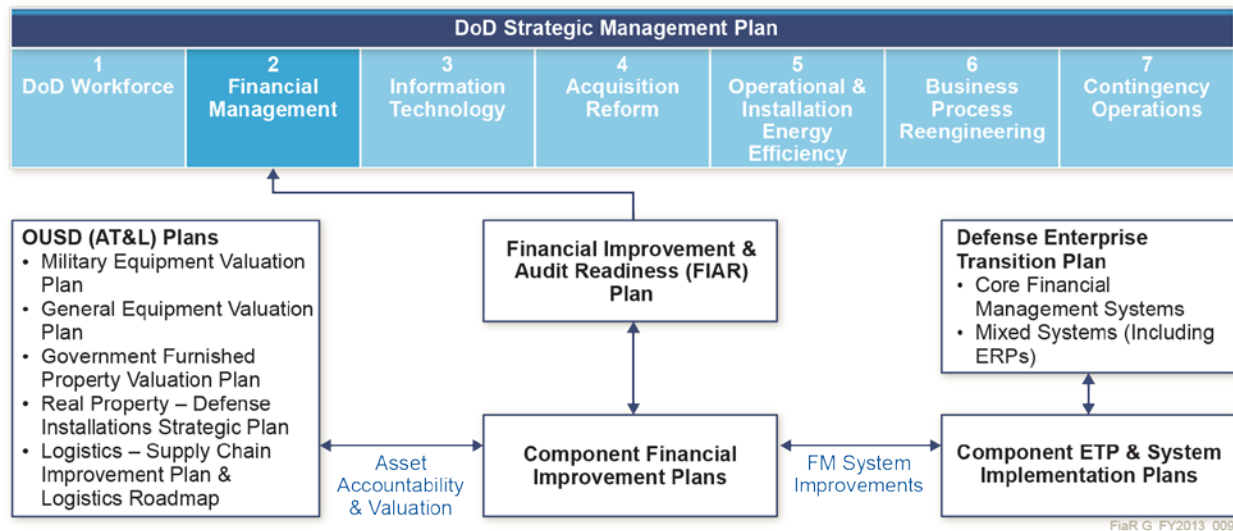
1. ICOFR and Internal Control over Financial Systems SOA memorandum signed by the Reporting Entity Senior Assessment Team (SAT) Chairman to OUSD(C). (Refer to FIAR Guidance website for [additional reporting instructions](#) and the latest [Statement of Assurance Memorandum](#) template). Refer to DoD FMR Vol.1 Chap 3 for guidance related to Internal Control over Financial Systems.
2. Summary Corrective Action Plans (CAPs) for each identified material weakness (if applicable) to the OSD Senior Accountable Official and OUSD(C) FIAR Directorate with the detailed CAPs updated in the respective FIPs. (Refer to FIAR Guidance website for the [Corrective Action Plan \(CAP\) Development Instructions](#) document, latest [Corrective Action Plan Template](#), and example [Corrective Action Plan](#)).

Items (1) and (2) above must be submitted no later than 10 business days after June 30th. The OSD Senior Accountable Officials in charge of the reported financial material weakness will meet with the reporting entities that have reported financial material weaknesses to monitor progress throughout the year for the Department.

Reporting entities must assess internal controls over financial reporting related to areas of high risk that have been previously reported as auditor-identified or self-identified resulting in a material weakness. Note that internal control testing must be performed on an annual basis. Therefore, reporting entities must continue to perform the related procedures each year even after reporting entities have attained an audit ready state.

2.G FIAR STRATEGY LINK TO THE DoD STRATEGIC MANAGEMENT PLAN

The Department's Strategic Management Plan (SMP), a requirement of the NDAA for FY 2008, establishes seven specific business goals to further articulate needed changes in the Department's "business domain" and to structure unity of effort across the enterprise. Business Goal 2, "Strengthen DoD Financial Management", as seen in **Figure 9**, identifies the Department's plans and their relationships to ensure Department leaders have access to timely, relevant and reliable financial and cost information to make informed decisions. One focus area of Business Goal 2 is to "sustain public confidence through auditable financial statements." Due to its size and complexity, the Department utilizes a "family of plans" approach to cascade enterprise business priorities into functional and organizational plans. These include the Enterprise Transition Plan (ETP) and the FIAR Plan supported by the Business Enterprise Architecture (BEA).



Progress relative to established goals is reported and monitored by a formal and regularly scheduled FIAR governance process that involves the Deputy Secretary of Defense, Under Secretary of Defense Comptroller (USD(C/CFO), DoD Deputy Chief Management Officer, Military Department Chief Management Officers and Financial Management/Comptrollers, along with senior leaders from the functional communities. The FIAR Guidance provides the strategy and methodology to integrate the Department and Component financial, acquisition, and ETPs.

The Business Goal 2 key initiative that drives auditability is "Execute the FIAR strategy and plans to achieve audit readiness by Fiscal Year (FY) 2017."

2.H SYSTEM TRANSFORMATION INITIATIVES

The Strategy integrates key elements of the ETP, which organizes and prioritizes efforts to modernize DoD business and financial processes and systems. The ETP is the roadmap that implements the BEA and defines specific implementation goals, milestones and measures for each fiscal year to reach the “to-be”, or future, envisioned state. It is a cohesive plan that implements and modernizes business systems within and across each functional area of the Department, and in effect provides consistency across all reporting entities.

For most of the Department, success in financial management improvement depends on system modernization and business transformation initiatives. Additionally, FIAR and ETP efforts must also be aligned to comply with Federal Managers Financial Integrity Act (FMFIA) requirements to maximize the effectiveness of limited resources and promote efficiency. The “to-be” dates in the ETP and the phasing out of existing systems must be considered in the development of reporting entity FIPs as reporting entities begin the Corrective Action Phase “Design Audit-Ready Environment” key task.

Reporting entities must assess the target dates of their “to-be” environments against their audit ready assertion dates in order to determine whether the existing systems or “to-be” systems (or both) should be included in their current audit readiness efforts. For reporting entity business processes currently using existing systems that will be modernized or replaced with ERPs by their audit ready assertion date, the “to-be” must be included in their audit readiness efforts and reflected in the FIPs. In these situations, reporting entities need to (1) assess existing processes, (2) identify those processes that will change with the new implementation, and (3) map modernized system/ERP requirements to known weaknesses. In situations where a system implementation will replace a process, the reporting entity should build the system implementation date into its FIPs as a dependency for remediating the associated controls and processes. The reporting entity FIPs must demonstrate that system requirements and transformation initiatives map to **FROs** and control activities that will ensure that system controls will be properly designed and will operate effectively to remediate known weaknesses.

Figure 10 is an example of an audit ready environment for the Procure-to-Pay business process where the current “as-is,” transitional, and target systems environments have been identified.

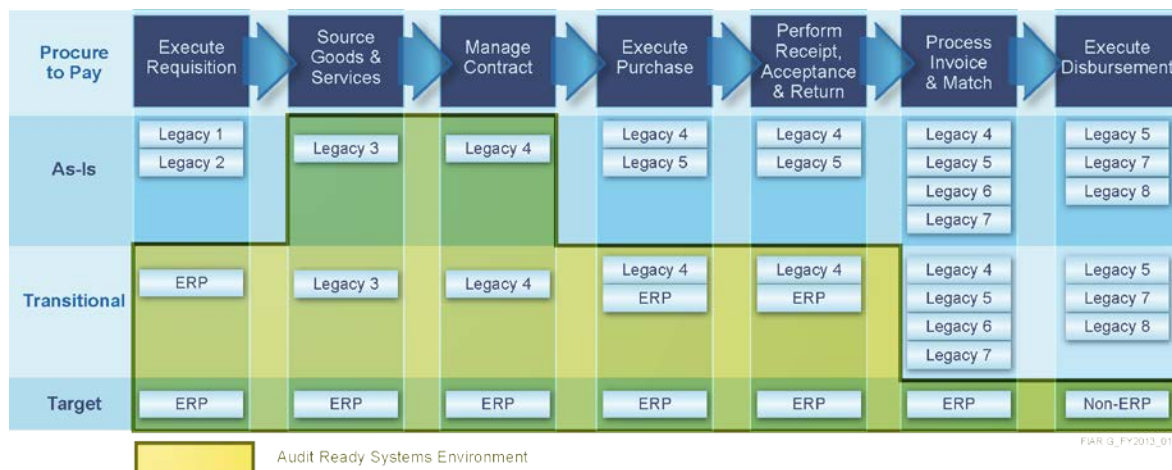


Figure 10. SBR Example- Corrective Action Phase- Design Audit Readiness Environment

It is important to note that auditability may be achieved before full system/ERP implementation; therefore not all existing systems can be scoped out of audit readiness efforts.

While reporting entities can evaluate the design of “to-be” system solutions, tests of operating effectiveness cannot be performed until the solution is implemented. Evaluating the design of these “to-be” solutions will help ensure that business processes and controls will be effective when the system solution is implemented and will help ensure that new processes and/or controls will meet FIAR objectives. Prior to the implementation of system solutions, reporting entities can implement compensating controls that mitigate identified risks and allow them to assert audit readiness.

2.1 ROLES AND RESPONSIBILITIES

2.1.1 Governance

The Department has implemented a governance structure that engages all of its key stakeholders. **Figure 11** provides a graphical representation of the structure, the participants, and their roles. The USD(C) and FIAR Governance Board provide the vision, goals, and priorities of the FIAR Strategy, which are coordinated with key stakeholders within the Department, e.g., Military Departments, as well as outside the Department (OMB and Congress). The Deputy Secretary of Defense/ Chief Management Officer (CMO) approves the vision, goals, and priorities.

2.1.2 FIAR Governance Board

The USD(C) and DCMO co-chair the FIAR Governance Board, which includes the Military Department DCMOs. The FIAR Governance Board engages the Department's most senior leaders from the financial management community along with the DCMOs and senior representatives from the Office of the Under Secretary of Defense (Acquisition, Technology and Logistics) (OUSD(AT&L)). The DCMOs have cross-community (business and financial) responsibilities and authority to transform budget, finance, and accounting operations, and to eliminate or replace financial management systems that are inconsistent or not aligned to transformation efforts.

2.1.3 DoD Reporting Entities (including their Major Commands) and Service Providers

Reporting Entities

The CFO Act, as amended by the Government Management Reform Act (GMRA), requires major agencies of the Federal Government to prepare and submit audited financial statements. Additionally, OMB requires the Department and several of its reporting entities, to prepare quarterly and annual stand-alone financial statements in accordance with OMB Circular A-136, "Financial Reporting Requirements." The DoD Agency-wide financial statements provide the financial status of the entire Department. In this guidance, the DoD reporting entities refer to entities within the Department that prepare stand-alone financial statements, as well as Other Defense

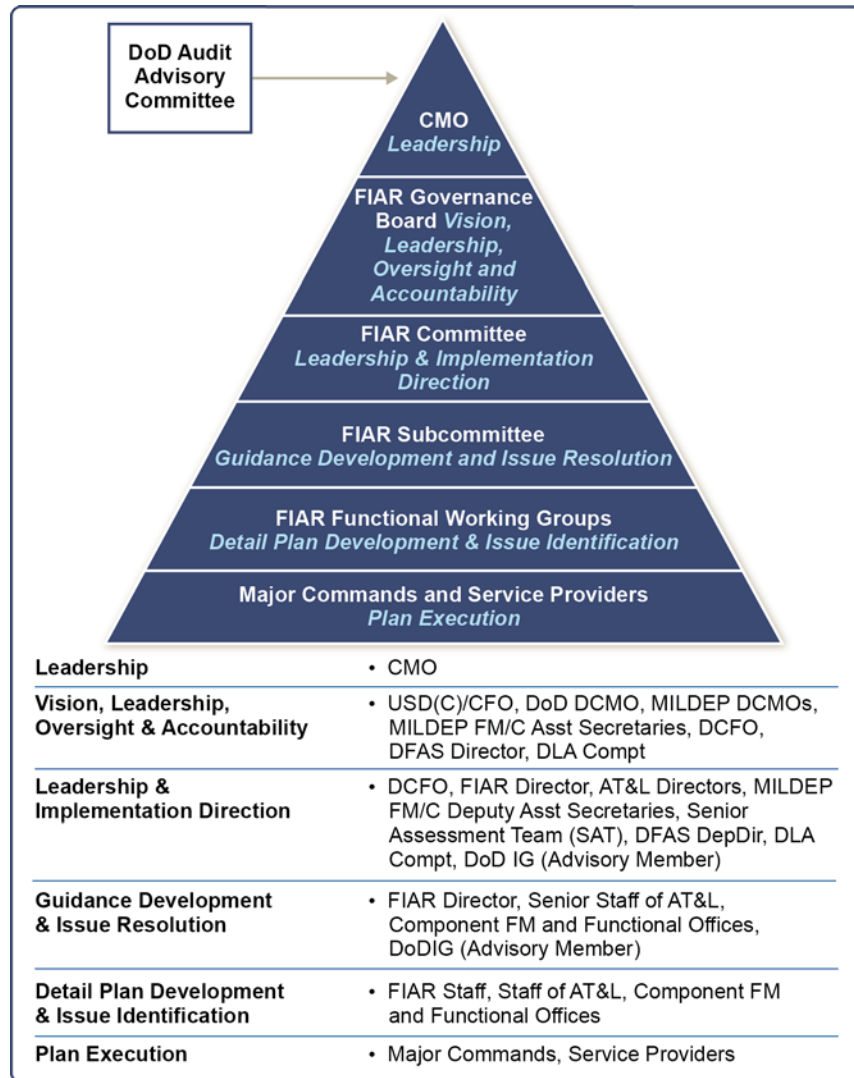


Figure 11. FIAR Governance spans from the CMO through Major Commands and Service Provider

Organizations (ODOs) entities and funds that are material to the DOD Agency-wide financial statements and perform audit readiness activities.

The reporting entities' major commands, such as the NAVFAC, execute the FIPs, perform the Discovery Phase tasks, test and strengthen internal controls, and correct deficiencies. It is within the major commands where business events occur that trigger financial transactions, and where the functional community engages with the financial community to achieve the vision, goals, and priorities of the USD(C). **Figure 12** illustrates the interconnection between reporting entities and service providers,⁷ entities that provide services to and are responsible for executing one or more significant business processes on behalf of the reporting entities, across the five Financial Improvement Elements (FIE).

Details for Service Providers is located in section 3.B. FIAR Methodology Service Provider.

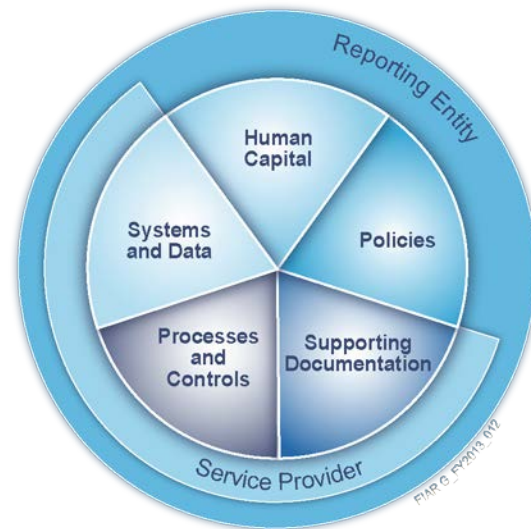


Figure 12. Service providers are responsible for portions of the financial improvement elements of customer reporting entities

⁷ 5 In AICPA literature, a service provider is normally referred to as a "service organization".

3. FIAR METHODOLOGY

3.A METHODOLOGY – REPORTING ENTITY

The Methodology is a mandatory set of standardized phases and tasks that reporting entities must follow to achieve audit readiness. The Methodology, shown in **Figure 13**, is discussed in the pages that follow.

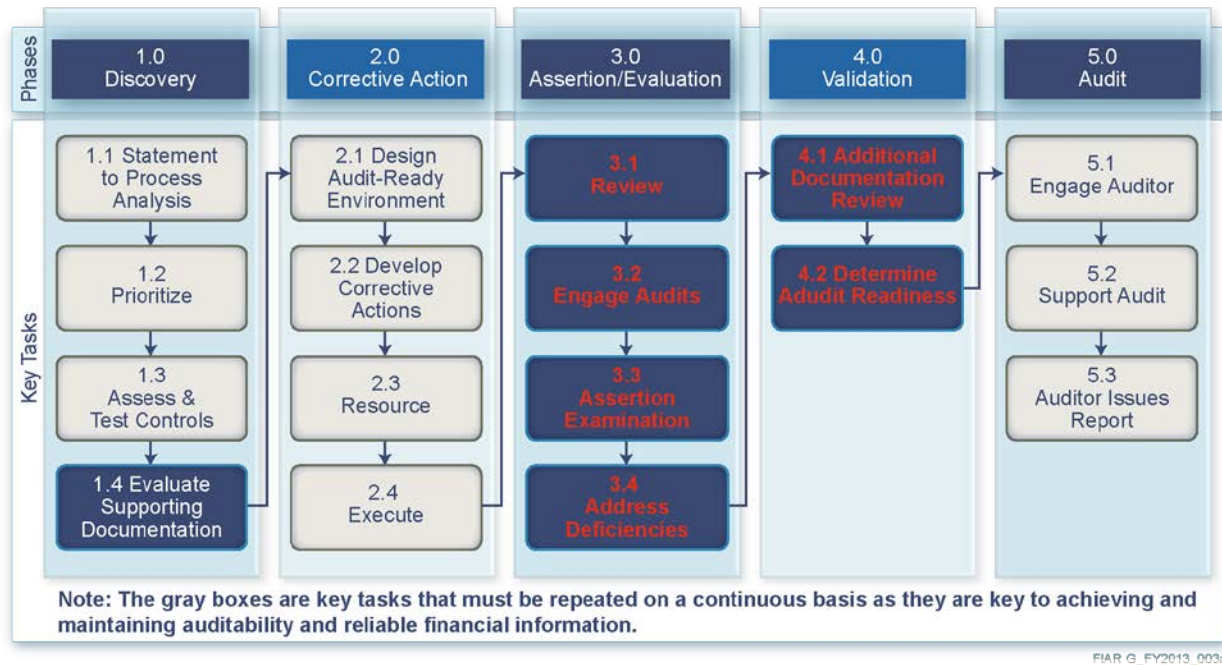


Figure 13. Phases and Key Tasks to Achieve Auditability and Reliable Financial Information

3.A.1 Phases and Key Tasks

The Financial Improvement and Audit Readiness (FIAR) Methodology consists of a series of phases, key tasks and underlying detailed activities that reporting entities must follow to improve financial information and achieve audit readiness. **Figure 13** graphically depicts the phases and the key tasks within each phase.

The phases and key tasks, which can be applied uniformly regardless of the size, materiality, or scope of an assessable unit, are as follows:

1. Discovery:

- a. Reporting entity documents business processes and its financial environment
- b. Reporting entity defines and prioritizes its processes into assessable units, and clearly defines the scope of its assertion and its strategy for achieving audit readiness (see **Figure 16**)
- c. Reporting entity identifies risks and financial reporting objectives and control activities, and tests the design and operational effectiveness of control activities
- d. Reporting entity evaluates the sufficiency and accuracy of documentation to support financial transactions, account balances and financial statement line items
- e. Reporting entity identifies and classifies any weaknesses and deficiencies in control activities and/or supporting documentation
- f. Reporting entity submits required work products to the FIAR Directorate for review in accordance with its Financial Improvement Plan (FIP) milestone dates; the FIAR Directorate reviews work

products to ensure all audit readiness dealbreakers have been addressed, and provides feedback and recommendations to the reporting entity on an ongoing basis

2. Corrective Action:

- a. Reporting entity defines and designs audit readiness environment, to include requirements for remediating deficiencies in internal controls and supporting documentation
- b. Reporting entity develops concrete corrective action plans (CAPs) to resolve each deficiency identified during the Discovery phase
- c. Reporting entity develops budget estimates of required resources (i.e., funding and staffing) to execute CAPs,
- d. Reporting entity executes CAPs and performs procedures to verify that CAPs have successfully remediated the deficiencies
- e. Reporting entity notifies the FIAR Directorate that Reporting entity is ready for an examination of its assessable unit

3. Assertion/Evaluation:

- a. FIAR Directorate evaluates documentation to determine audit readiness state.
- b. FIAR Directorate provides feedback to the Reporting Entity on its status of audit readiness
- c. FIAR Directorate engages auditor to perform an examination of the reporting entity's audit readiness assertion; auditor identifies deficiencies, if any
- d. Reporting entity evaluates the nature and extent of deficiencies noted and implements corrective actions to remediate deficiencies
- e. Reporting entity performs procedures to verify that corrective actions successfully remediated auditor identified deficiencies

4. Validation:

- a. Reporting entity submits examination report and additional documentation demonstrating successful remediation of auditor identified deficiencies to the FIAR Directorate and Department of Defense Office of Inspector General (DoD OIG)
- b. FIAR Directorate reviews examination report and additional documentation supporting successful remediation of deficiencies, and determines reporting entity's audit readiness state

5. Audit:

- a. Reporting entity engages an auditor
- b. Reporting entity supports specified elements audit (Wave 3) or full scope financial statement audits
- c. Auditor issues audit opinion

Reporting entities are responsible for executing the key tasks and activities in the *Discovery* and *Corrective Action* phases, including developing all required assertion work products to support their audit readiness assertion for their assessable units or financial statements. The OUSD(C) then engages an independent auditor to perform an examination on management's audit readiness assertion in the *Assertion/Evaluation Phase*. The reporting entity is responsible for implementing CAPs to remediate any auditor identified deficiencies, and must perform procedures to verify that the corrective actions successfully remediated the deficiencies. OUSD(C) reviews the independent auditor examination report and additional documentation supporting successful remediation of deficiencies to determine the reporting entity's audit readiness state. Once OUSD(C) validates that the reporting entity is audit ready, the reporting entity engages an independent auditor to perform the audit of the assessable unit or financial statement(s) in the *Audit Phase*.

Once the reporting entity asserts audit readiness for the entire SBR (overall Wave 2), the reporting entity will initially be subjected to a “Specified Elements Audit” in accordance with AU 623, “Special Reports”. In the first year under audit, the reporting entity will undergo an audit of schedules containing only current year appropriations and all related activity (i.e., obligations, outlays, etc.) against those appropriated funds. To undergo the first year audit, the reporting entity must prepare a Schedule of Current Year Budgetary Resources to include all information related to appropriations beginning with the current year, following the guidance in the OMB Circular No. A-11, “Preparation, Submission, and Execution of the Budget” for preparation of the SF 133 (Report on Budget Execution and Budgetary Resources) and the related note disclosures, following the guidance in OMB Circular A-136 “Financial Reporting Requirements.”

In subsequent years until an unqualified opinion is received, the reporting entity will commence audits of schedules of both current year and prior year audited appropriations and all related activity against those appropriated funds. Through each successive audit, the ending audited balances carry forward to the subsequent year’s beginning balance, thereby reducing the percentage of unaudited beginning balances each year. The approach for auditing schedules of appropriation activity provides critical insight into whether a reporting entity’s current business and financial practices, processes, controls, and systems support auditability. Reporting entities will commence a full scope financial statement audit of the entire SBR once they receive an unqualified opinion on their schedule(s) of budgetary activity.

Reporting entities are also required to annually prepare and submit a SOA over internal controls over financial reporting and internal control over financial systems. This is not a separate phase, rather an annual requirement that must be performed regardless of the audit readiness status of the reporting entity. Requirements related to the submission of the annual statement of assurance including the summary CAP are described in Section 2.F. Please refer to the FIAR Guidance website to obtain the latest [Statement of Assurance Memorandum](#) Template and the [Corrective Action Plan](#) Template.

The terms “audit,” “examination,” and “specified elements audit,” used throughout this document are defined as:

- Financial statement audit (Audit) – The primary purpose of a financial statement audit is to provide reasonable assurance through an opinion (or disclaimer of an opinion) about whether an entity’s financial statements are presented fairly in all material respects in conformity with United States (U.S.) generally accepted accounting principles (GAAP). These audits are performed in accordance with Generally Accepted Government Auditing Standards (GAGAS).
- Examination – Consists of obtaining sufficient, appropriate evidence to express an opinion, in accordance with GAGAS, on whether the subject matter is based on (or in conformity with) criteria⁸ that are suitable (i.e., objective, measurable, complete and relevant) and available to users, in all material respects or the assertion is presented (or fairly stated), in all material respects, based on the criteria. See Section 2.D for example management assertion template to be used when engaging an auditor for an *Assertion/Evaluation Phase* audit readiness examination.
- Specified elements audit⁹ – Consists of an independent auditor conducting an audit in accordance with GAGAS and AU623, Special Reports, to obtain sufficient, appropriate evidence to express an opinion in connection with specified elements, accounts or items of a financial statement.

⁸ “Criteria” are the standards or benchmarks used to measure or present the subject matter and against which the practitioner evaluates the subject matter. Management may establish criteria for an examination; however, practitioners will evaluate management’s criteria to ensure that it is suitable, that is, relevant, measurable, complete and objective. (<http://www.aicpa.org/Research/Standards/AuditAttest/DownloadableDocuments/AT-00101.pdf>)

⁹ The SBR audit will initially be limited to a “Specified Elements Audit” since the scope will be limited to audits of “schedules” containing only current year appropriations and all related activity against those appropriations. Audits of schedules containing only current year activity will provide the opportunity to assess progress and identify any issues in a way that a disclaimer on full financial statements do not.

3.A.2 Consideration of Service Providers

Embedded within the Methodology's phases are the reporting entity's considerations of its service providers and how their activities affect its financial processes and related audit readiness.

Reporting entities' management is responsible for the internal control over their financial information and, therefore, must ensure that they understand what financially significant activities are outsourced to service providers and the effectiveness of the service providers' related internal controls. In turn, service providers are responsible for providing a description of their controls that may affect their customer reporting entities' control environment, risk assessment, control activities, and information and communication systems. The description of controls should be detailed enough to provide the reporting entity auditors with sufficient information to assess the risks of material misstatement. For a detailed discussion of service providers' role in the Methodology, see Section 3.B.

3.A.3 Assessable Units

Reporting entities must follow the Methodology for each assessable unit. Assessable units can vary between line items, processes, systems, or classes of assets, depending on the wave and reporting entity preferences. These assessable units can be further separated into assessable sub-units at the entity's discretion. **Reporting entities must establish assessable units for all processes, systems, or classes of assets that result in material transactions and balances in their financial statements.** As noted in Section 2.D, reporting entities must clearly define the beginning/initiation and end of the process for each assessable unit that is not a financial statement line item. Additionally, established assessable units should not be duplicative or overlap. To ensure completeness of assessable units, reporting entities should prepare quantitative drill downs depicting the dollar volume of activity flowing through each assessable unit consistent with the tasks in the *Discovery Phase* key activity 1.1.2. Wave- specific considerations when identifying assessable units are included in the following paragraphs. During the examination the IPA will determine the nature, extent, and the timing necessary to render an opinion.

Waves 1 & 2

The USD(C) has pre-defined one assessable unit for the SBR, Appropriations Received, which represents Wave 1. Due to its limited scope, the USD(C) has pre-defined this assessable unit for all reporting entities and directed them to prioritize this assessable unit to allow the Department to demonstrate immediate progress. Refer to **Appendix C** for a more detailed discussion of the scope of this wave.

Beyond Wave 1, reporting entities have the flexibility to determine their appropriate assessable units for the remainder of the SBR (Wave 2). Assessable units for the SBR may be subaccounts that make up the obligations line item, classes of financial transactions or processing systems. For example, the "Obligations Incurred" line item on the SBR is comprised of many types of financial transactions that are processed through many systems. Assessable units within the "Obligations Incurred" line item may be comprised of classes of financial transactions, such as contractor payments, military pay, and civilian pay. For example, an assessable unit may be a class of transactions or it may also be all financial transactions that are processed through a particular system. Determining assessable units is a key task of preparing for auditability because the assessable units provide the focus for financial improvement efforts.

Waves 3 & 4

For Waves 3 & 4, assessable units include classes, categories, or groupings of all accountable assets. Asset-related assessable units may also be groups of data within an Accountable Property Systems of Record (APSR), such as the Reliability and Maintainability Information System (REMIS), which is used by the Air Force for aircraft accountability, and the Defense Property Accountability System (DPAS), which is used by the Marine Corps (and other reporting entities) for GE. When the data in an APSR defines the assessable unit, the scope will include all mission critical assets within the system. Examples of assessable units for these waves include:

- Aircraft,
- Satellites and satellite launchers,
- Intercontinental ballistic missiles,
- Unmanned aerospace vehicles, and
- Externally carried pods.

For Wave 4, assessable units also include non-asset material financial statement line items on the Balance Sheet, Statement of Net Cost and Statement of Changes in Net Position (i.e., Environmental and Disposal liability, Military Retirement Benefits, Other Liabilities- Non Federal and Other Liabilities- Non Intragovernmental). It is important to note that Wave 4 assessable units exclude line items, accounts or balances that were addressed in an earlier wave (see discussion in section 2.C.4 for more information on Wave 4 assessable units).

3.A.4 Financial Systems Considerations

Reporting entities are responsible for internal controls relevant to financial information systems through which their transactions are processed. **Reporting entities must ensure that the requirements set forth in GAO's Federal Information System Controls Audit Manual (FISCAM) are met for the systems that are necessary to achieve financial improvement and audit readiness.** The GAO's FISCAM is comprised of three sections for internal controls relevant to financial information systems:

- Entity Level Information Technology General Controls (ITGCs),
- Application Level ITGCs, and
- Automated Application Controls.

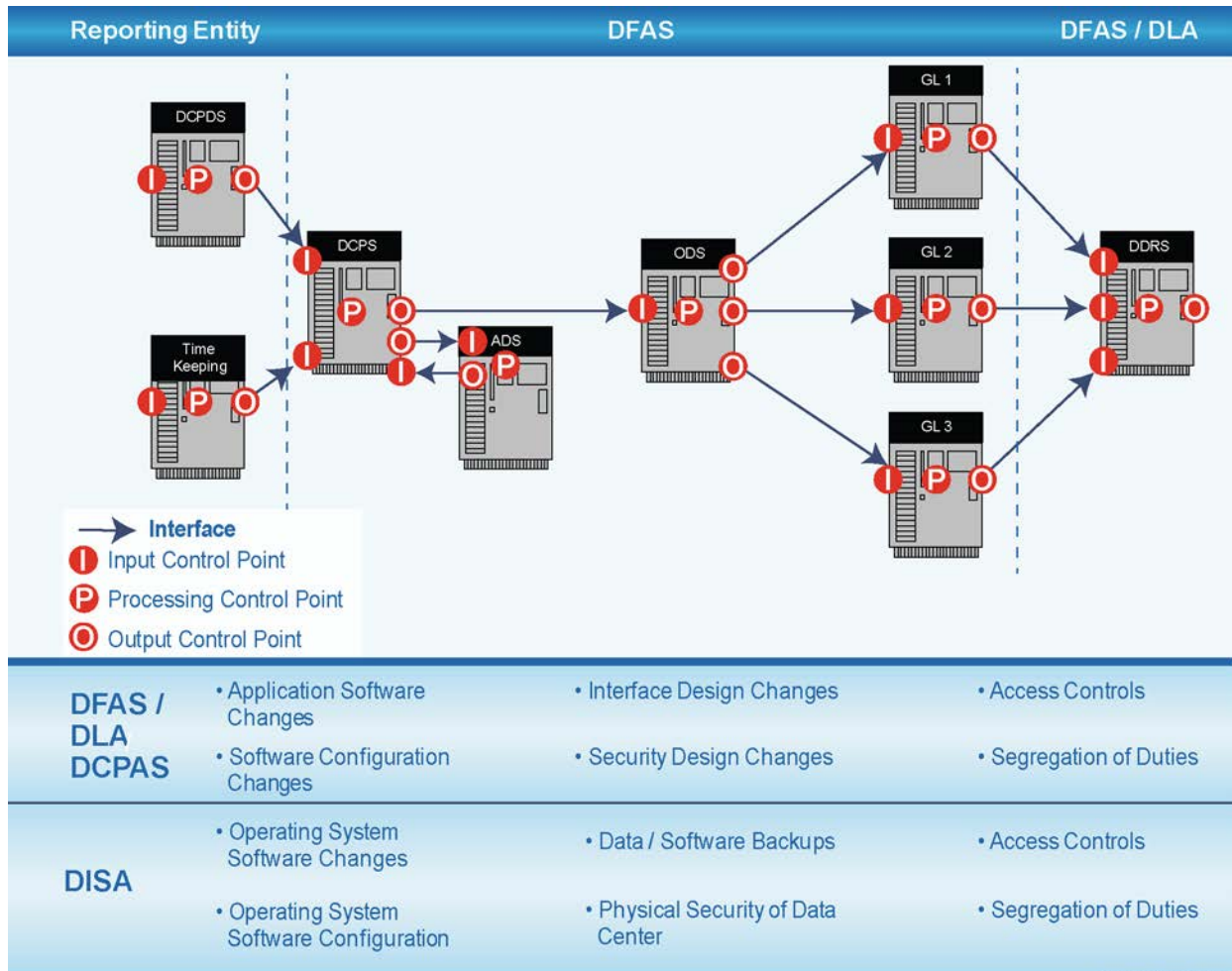
Entity Level ITGCs consist of: Security Management, Access Controls, Configuration Management, Segregation of Duties, and Contingency Planning. Entity Level ITGCs are pervasive across platforms and affect the entire organization. Application Level ITGCs cover the same basic controls as Entity Level ITGCs, but focus solely on the business and/or financial system and any feeder systems.

Automated Application Controls use a different set of control categories (Application Security, Business Process Controls, Interface and Conversion Controls and Data Management System Controls) and focus on a specific application (e.g., STANFINS, Defense Civilian Pay System, etc.).

In those instances where reporting entities have identified, documented the design, and tested the operating effectiveness of internal controls during DoD Information Assurance Certification and Accreditation Process (DIACAP) or other certification and accreditation efforts, this work may be leveraged to complete the FISCAM steps relevant for financial reporting, but is not a substitute. The extent to which the results can be leveraged will be determined by the degree to which it meets FIAR controls documentation and testing requirements. The FIAR Directorate has identified the FISCAM control activities and techniques needed to address the key internal controls over financial reporting risk areas most likely to be present based on the Department's experience. A summary analysis of those [FISCAM control activities and techniques](#) that have the highest relevance to addressing key risk areas for financial reporting and other FISCAM control activities and techniques that should be considered by reporting entities in their audit readiness efforts can be found on the FIAR Guidance website.

Per DoD Instruction (DoDI) 5010.40, reporting entities are required to report, as part of their SOA, whether their financial systems comply with the requirements of Federal Financial Manager's Improvement Act (FFMIA), also known as internal controls over financial management systems.

As illustrated in the system view diagram included as **Figure 14**, in some cases, reporting entity financial systems may be owned and/or operated by executive agents and the transactions that flow through those systems may be processed by a service provider. In such situations, the reporting entity still has the ultimate responsibility for information technology controls over those systems through which its financial transactions flow, and will need to communicate and coordinate audit readiness efforts with the executive agent and service provider. Section 3.B provides a discussion of reporting entity and service provider roles and responsibilities in the execution of the Methodology and FIP reporting.



FIAR G_FY2013_014b

Figure 14. System View Diagram: Reporting entities must consider information technology input, process, output and general computer controls for all relevant reporting entity and service provider systems

Financial system controls are important to reporting entity audit readiness because system outputs (e.g., system reports) and electronic evidence (e.g., electronic invoices) may serve as KSDs for both the operating effectiveness of controls and transactions/balances. There are varieties of systems that must be considered in reporting entity audit readiness efforts, such as: general ledger systems, source/feeder systems, system interfaces, disbursing systems, reporting systems, and property management systems. **Therefore, reporting entities must ensure adequate entity-level and application-level ITGCs and automated application controls are in place or appropriate corrective actions are planned and implemented. The reporting entity must identify all key systems and feeder systems that affect the assessable unit being asserted as audit ready. These key systems have been evaluated and IT controls have been identified and tested if the reporting entity's**

- **Controls within the system are identified as key controls in the controls assessment**
- **Systems are used to generate or store original key supporting documentation, or**
- **Reports from a system are utilized in the execution of key controls.**

In addition, if reporting entities are implementing an Enterprise Resource Planning (ERP) or system modernization and the system is a solution for resolving audit impediments, the reporting entity should map known process and control weaknesses to the new system's requirements to ensure that the new system will adequately address the impediment. For example, reporting entities with Environmental Liability material weaknesses should reference the Deputy Under Secretary of Defense Installations and Environment (DUSD (I&E)) Environmental Liability business process reengineering requirements for mapping to their ERP and control objectives provided as **FROs**.

It is important to note that, financial systems may not be limited to traditional, large/complex legacy or ERP systems. There may be instances where end user computing tools such as spreadsheets, databases, or other software tools impact key controls or calculations that are relevant to financial reporting. These end user computing tools are sometimes referred to as "micro-applications". Micro-applications require control techniques that are aligned to the IT general and application control objectives. Reporting entities must evaluate the risk of micro-applications on the associated financial processing. For example, risk to the financial process can increase when the number of transactions and dollar value processed by the micro application increases. Implemented control techniques for these micro applications should be commensurate with the relative sophistication of the software tool and its impact on internal controls over financial reporting. Examples of control technique include restricted shared directories, password protections of files, locking cells and formulas, enabling edit macros, enforcing segregation of duties, and creating a change management process.

When identifying information technology applications that are relevant to audit readiness assertions, Reporting Entities and Service Providers should also ensure they identify the specific "instances" of the application upon which their data resides--and ensure appropriate IT general and application control testing is performed on their specific instances. For example, the Department has four separate instances of its civilian personnel system, the Defense Civilian Personnel Data System (DCPDS). While the Defense Civilian Pay Advisory Service (DCPAS) is the system owner of DCPDS and is responsible for maintaining and updating the DCPDS application, the Army, Navy and Air Force each host an instance of DCPDS in their own data centers, in addition to the of DCPDS hosted by a DCPAS contractor. Therefore, Reporting Entities whose civilian personnel data resides on the Army's instance of DCPDS would need to coordinate with both the Army (for certain IT general controls) and DCPAS (for certain IT general and application controls), while a Reporting Entity whose civilian personnel data resides on the DCPAS instance of DCPDS would only need to coordinate with DCPAS.

3.A.5 Detailed Activities

Key tasks are essential to accomplish each of the five phases. The Methodology provides guidance to the reporting entities on the detailed activities that should be performed within key tasks that result in outcomes and work products that are essential to achieve audit readiness.

As the reporting entities prepare and execute their FIPs to accomplish the USD(C) priorities for budgetary and mission critical asset information, these detailed activities should be reflected in their FIPs as key tasks within the appropriate phase. See FIAR Guidance Website for [Wave 2](#) and [Wave 3](#) example work products (described in **Figures 15 – 28 below**) required to be prepared as part of achieving auditability and reliable financial information for the Department.

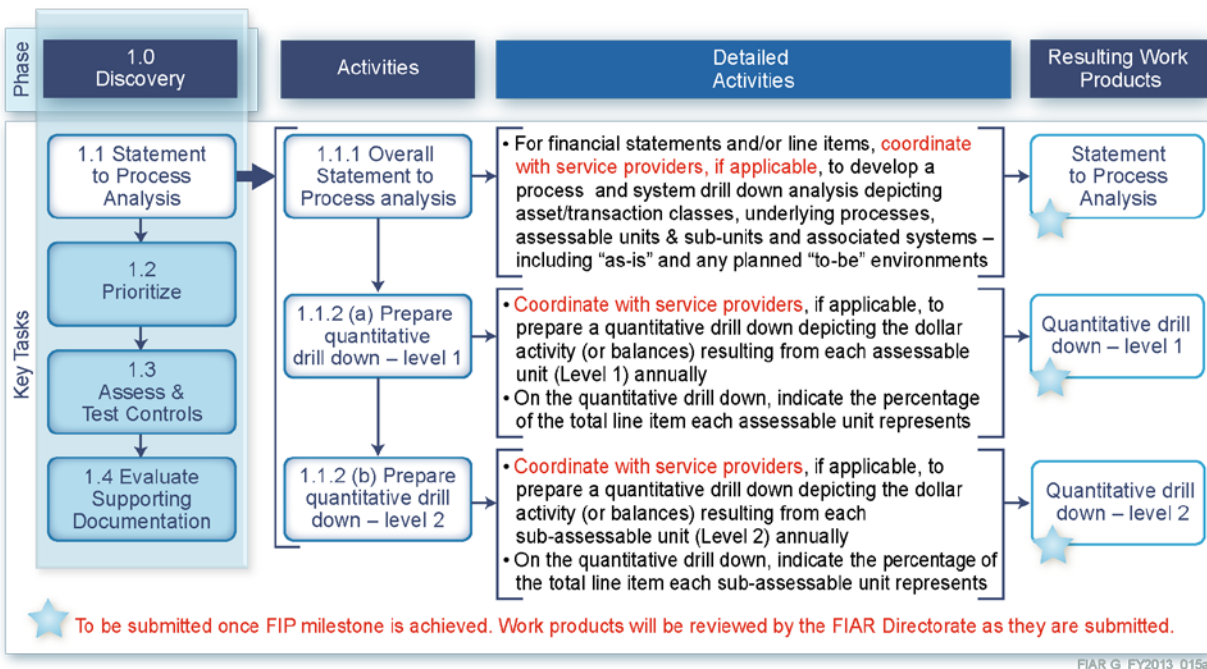


Figure 15. Discovery Phase – Statement to Process Analysis

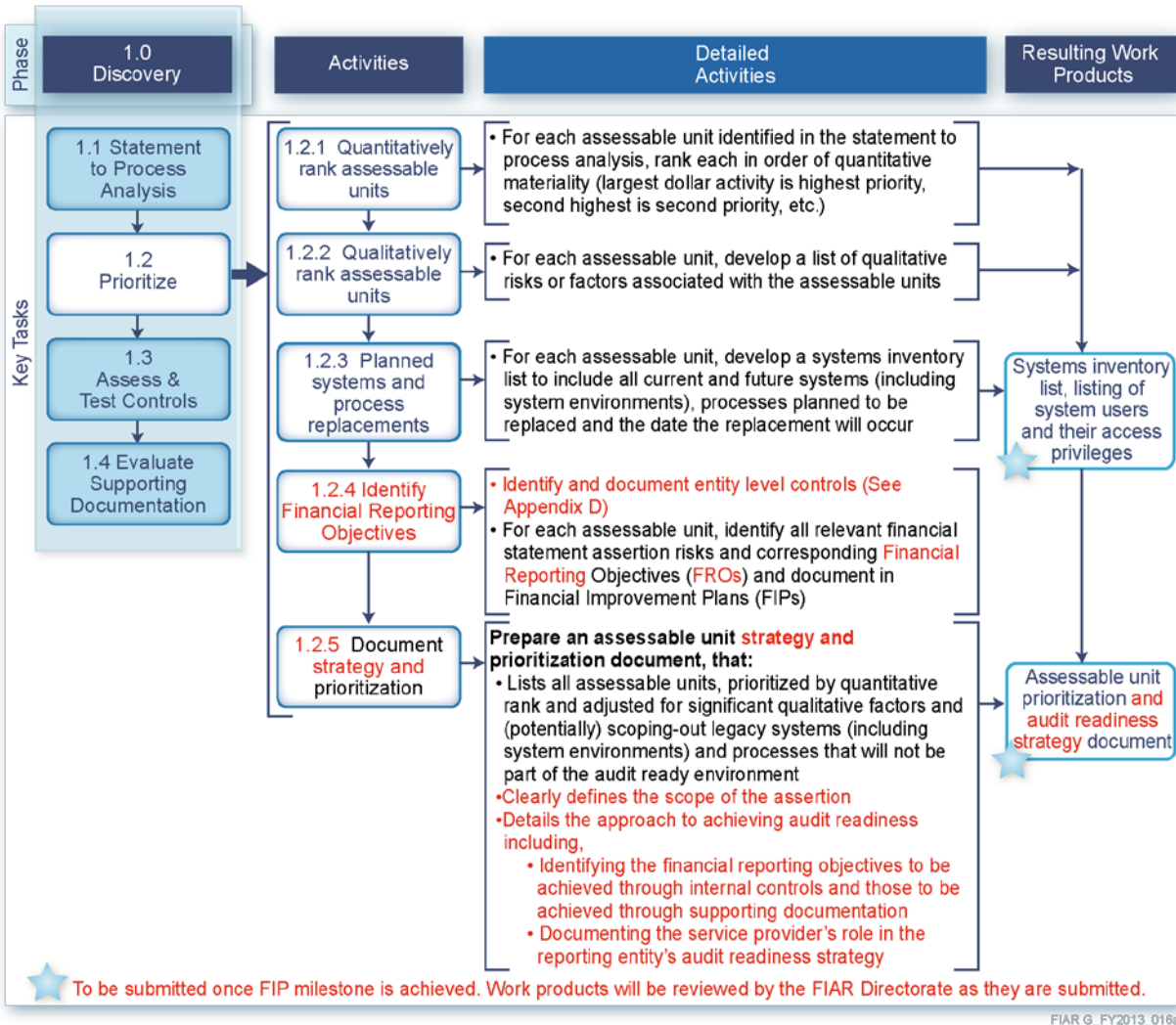


Figure 16. Discovery Phase – Prioritize

Reporting entities will be required to prepare and submit an assessable unit prioritization and audit readiness strategy document that clearly defines the scope of their audit readiness assertion.

When defining the scope, reporting entities must:

- Provide an overall summary of the assertion
- Identify the “in-scope” processes and manual controls
- Identify the “in-scope” IT Applications, Micro-Applications and associated IT General and Application controls
- Identify the key supporting documents (KSDs) included in the assertion
- Identify the role of the service providers (including discussion of relevant SSAE No. 16 reports and self-review efforts)
- Identify any exclusions (processes, controls, systems) from the scope of the assertion

By clearly defining the scope of the audit readiness assertions, reporting entities will help facilitate a more effective review of the assertion documentation by the FIAR Directorate.

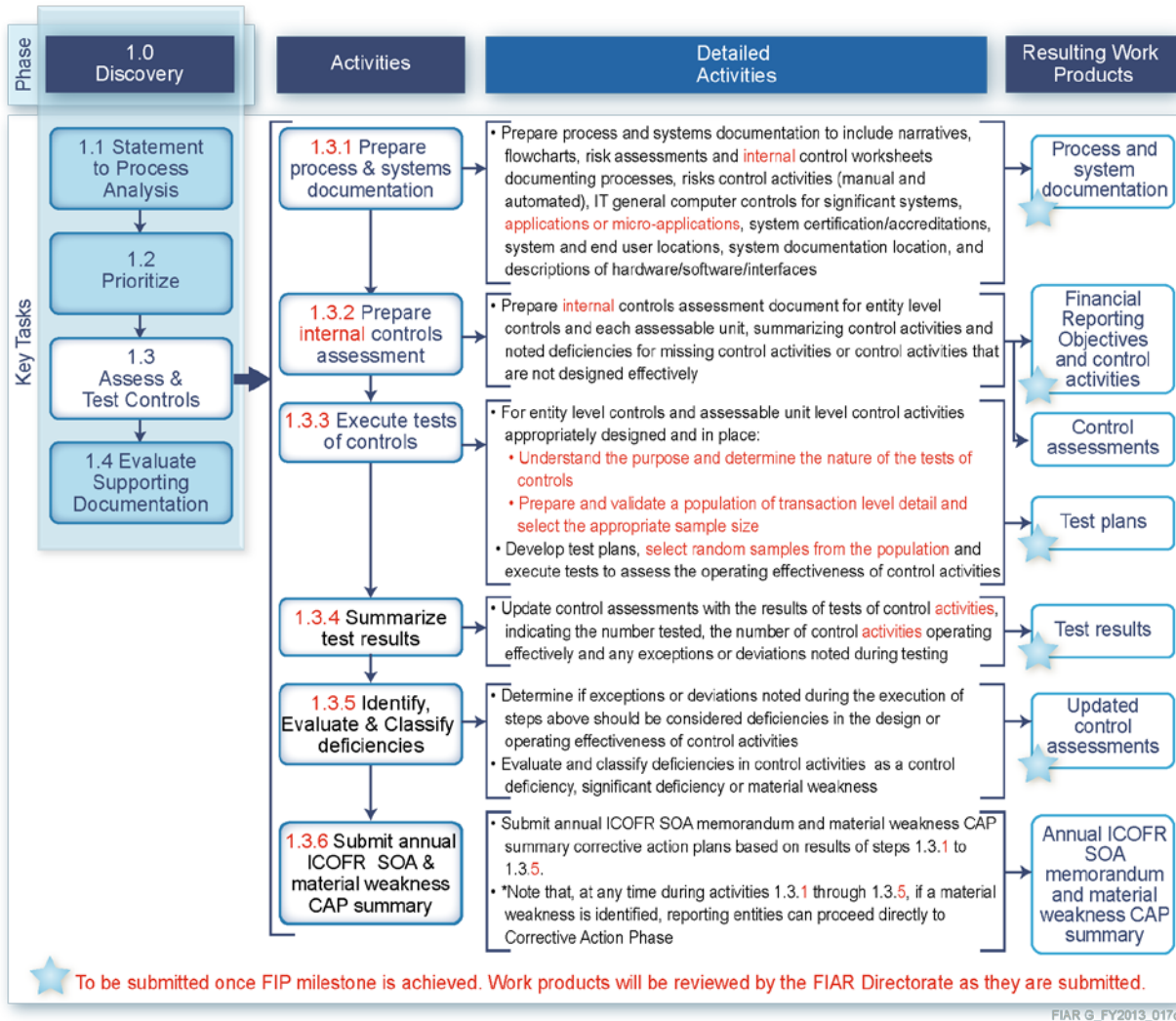


Figure 17. Discovery – Test Controls and Develop ICOFR Statement of Assurance

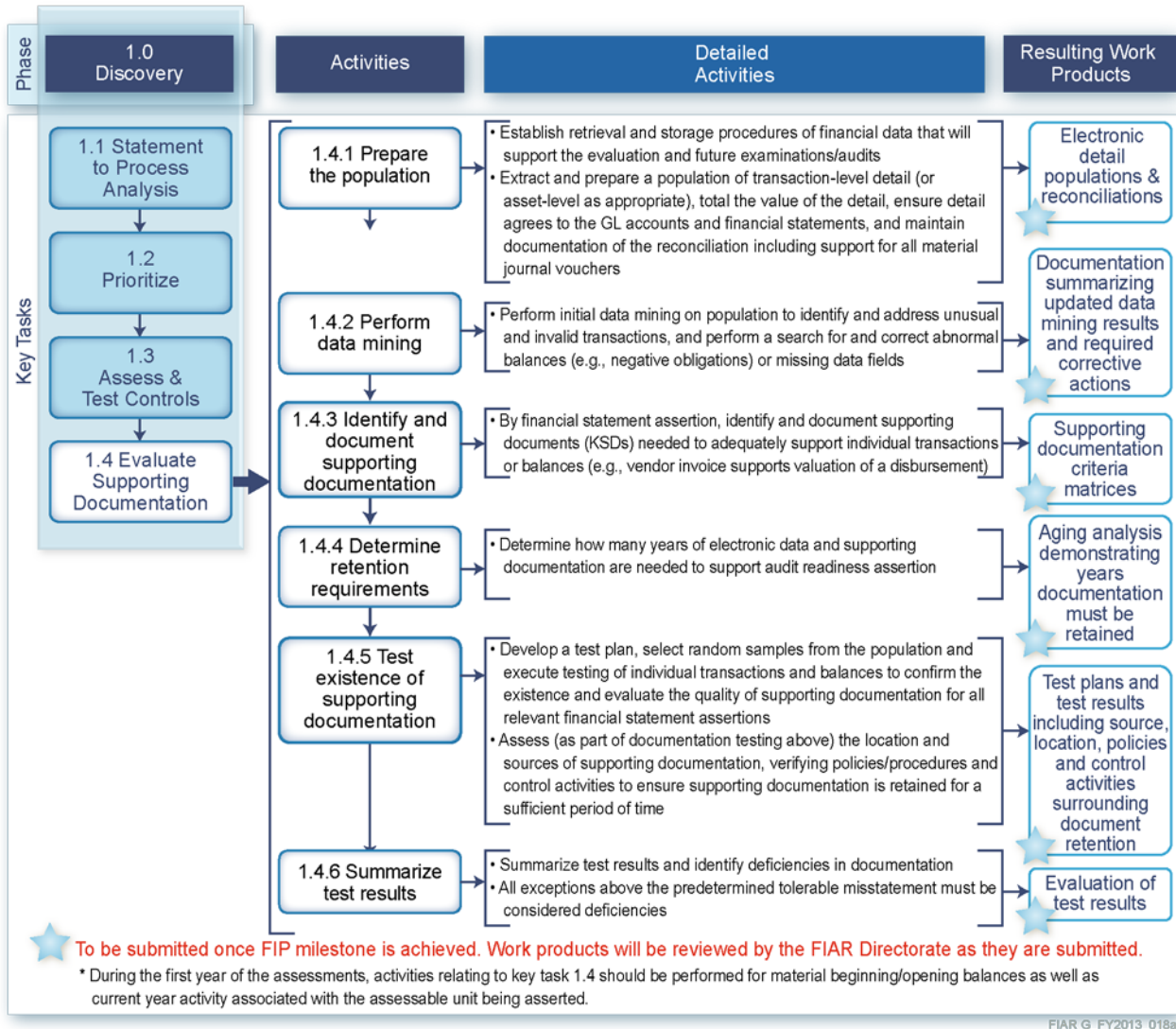


Figure 18. Discovery Phase – Evaluate Supporting Documentation

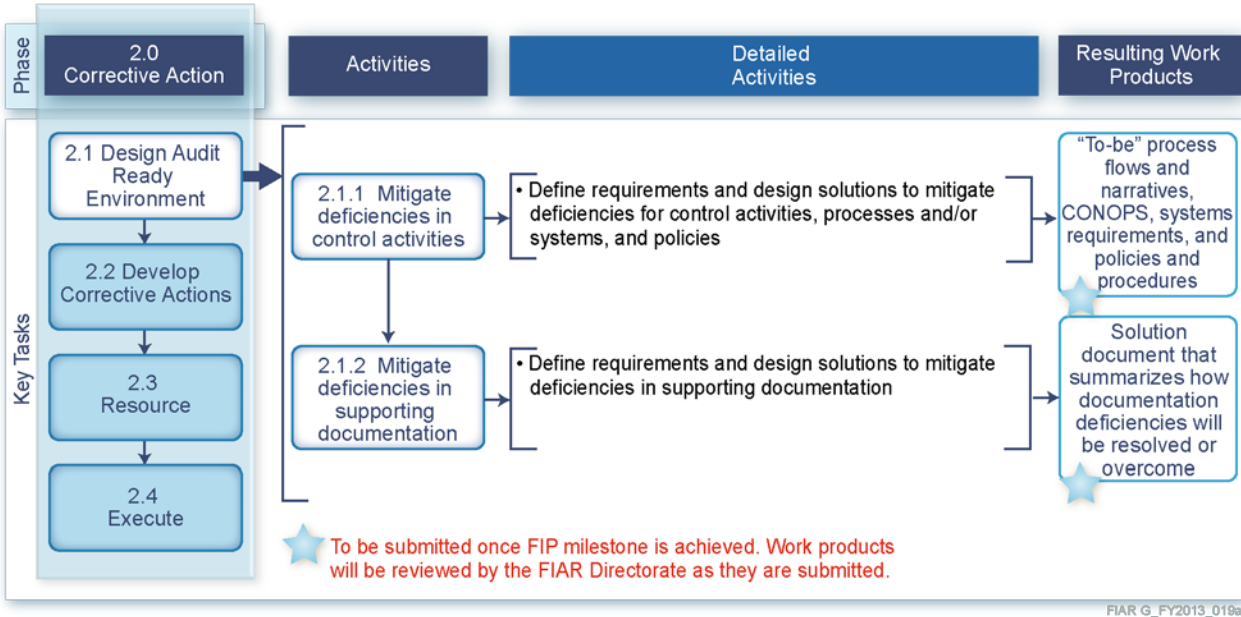


Figure 19. Corrective Action Phase – Design Audit Ready Environment

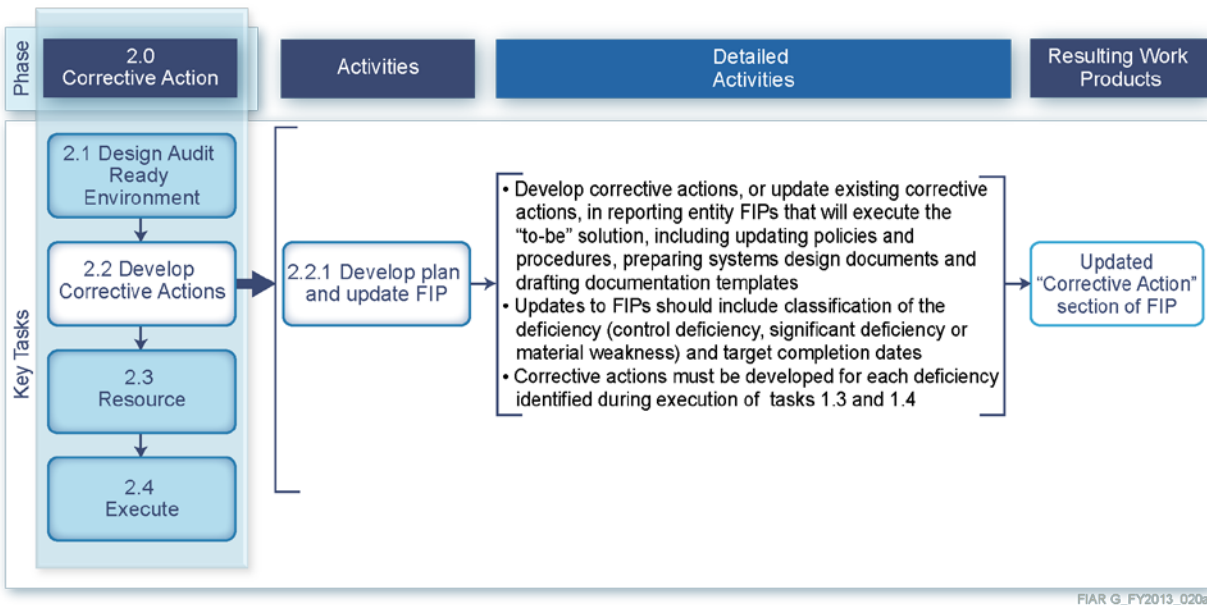


Figure 20. Corrective Action Phase – Develop Corrective Actions

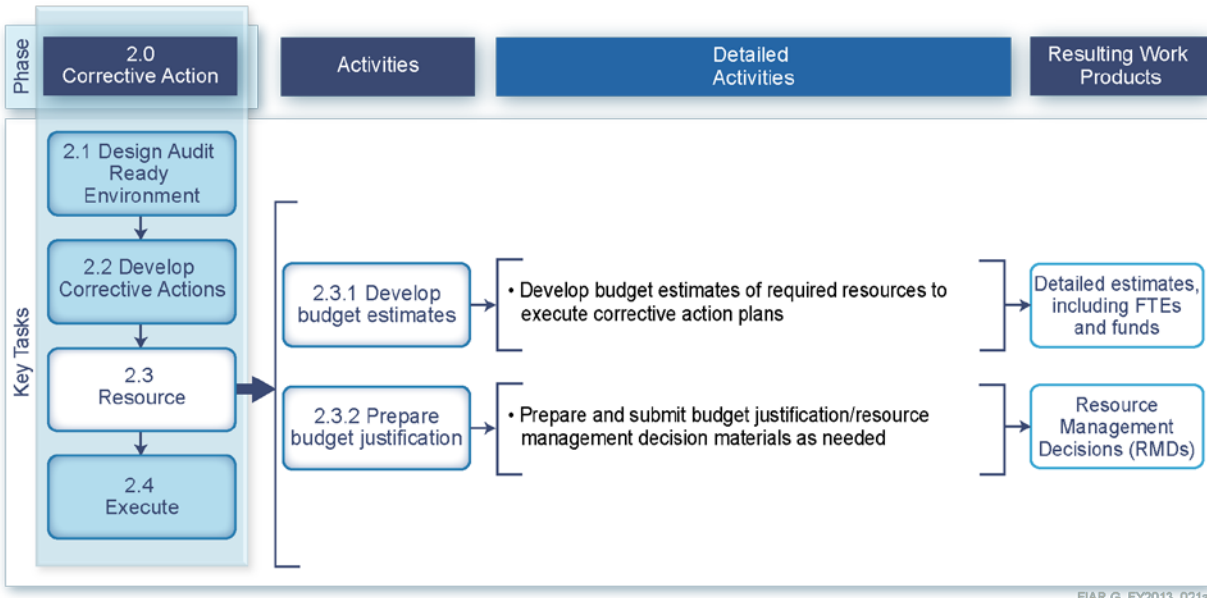


Figure 21. Corrective Action Phase – Resource

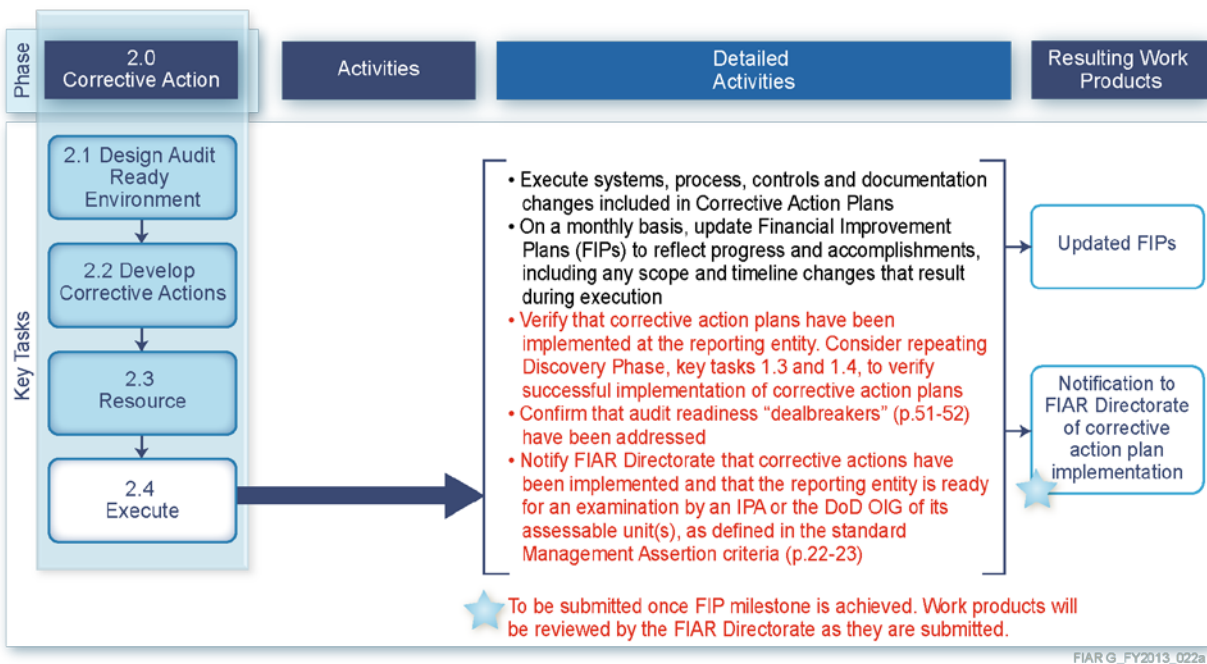


Figure 22. Corrective Action Phase – Execute

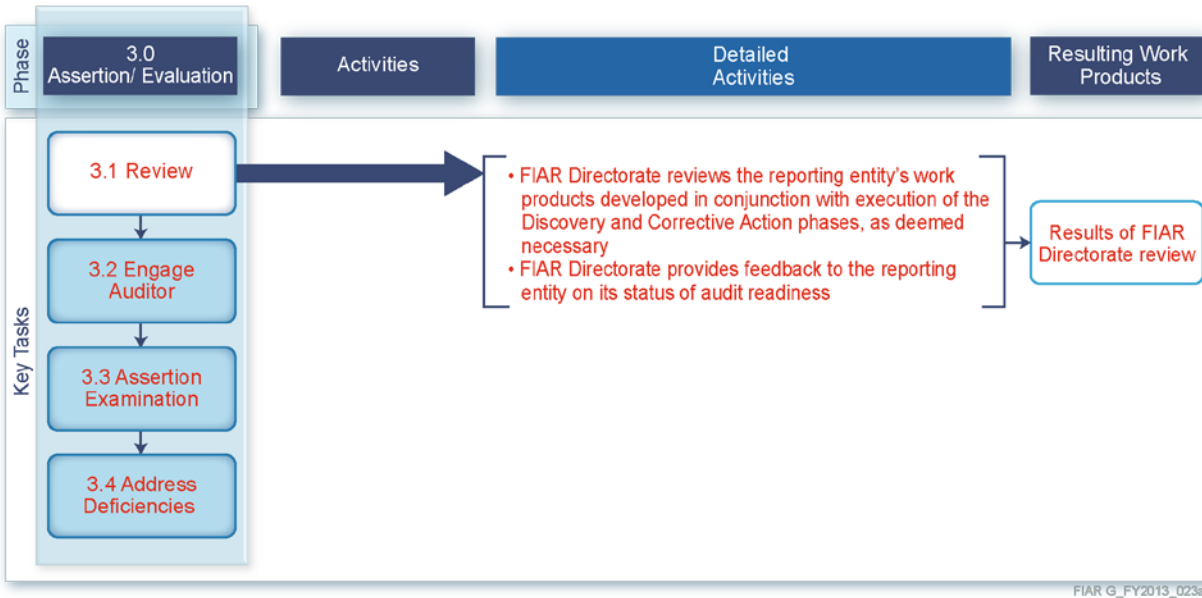


Figure 23. Assertion/Evaluation Phase – Review and Concurrence

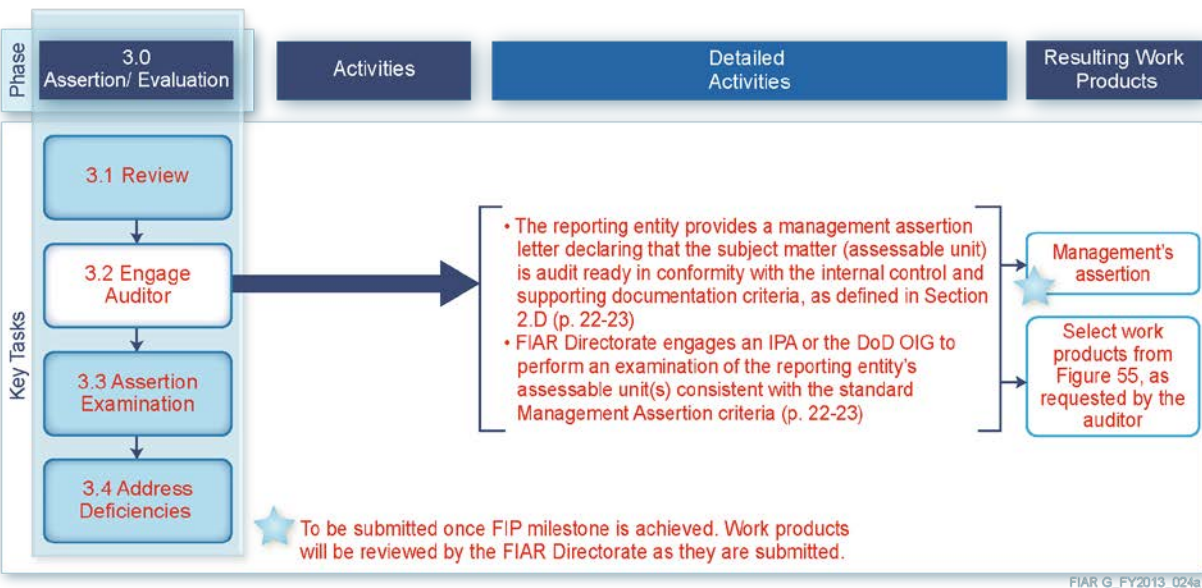


Figure 24. Assertion/Evaluation Phase– Engage Auditor

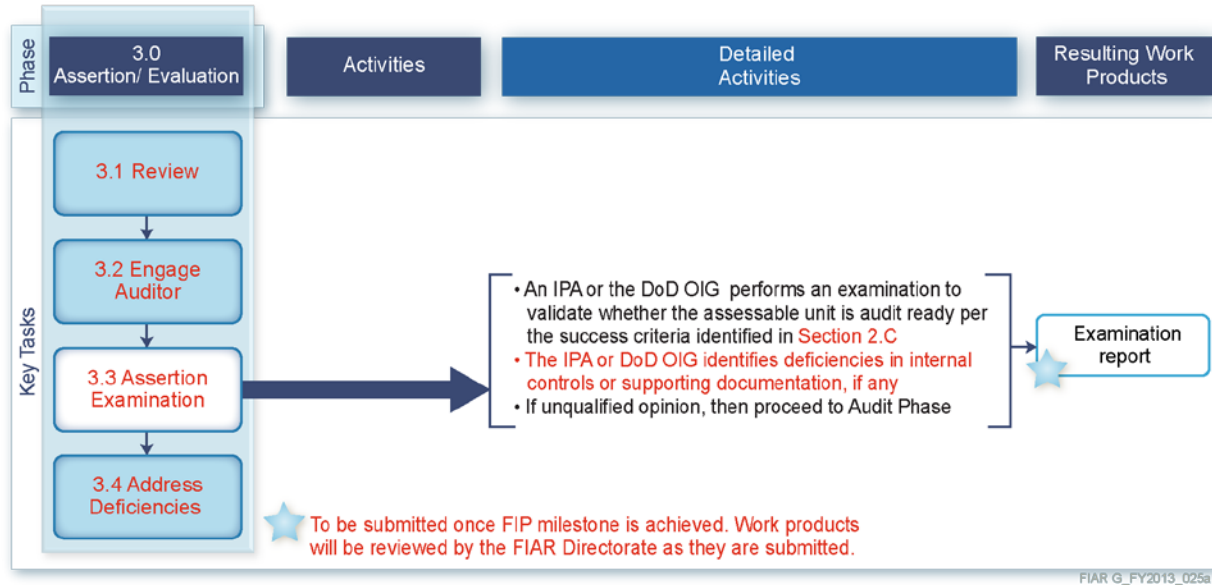


Figure 25. Assertion/Evaluation Phase— Assertion Examination

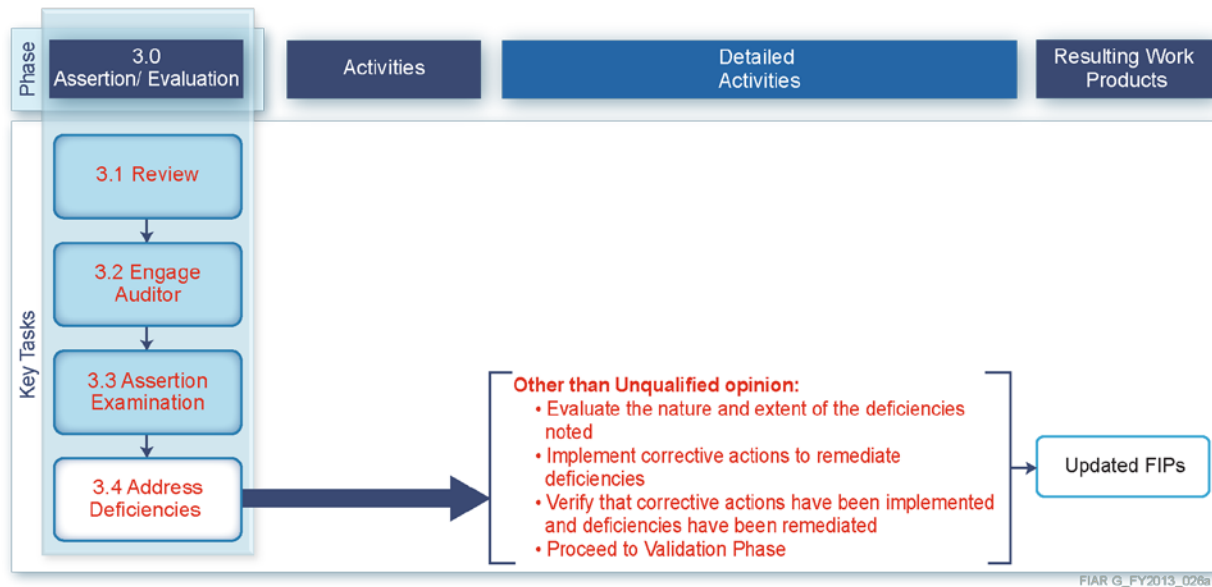


Figure 26. Assertion/Evaluation Phase— Proceed to Validation Phase

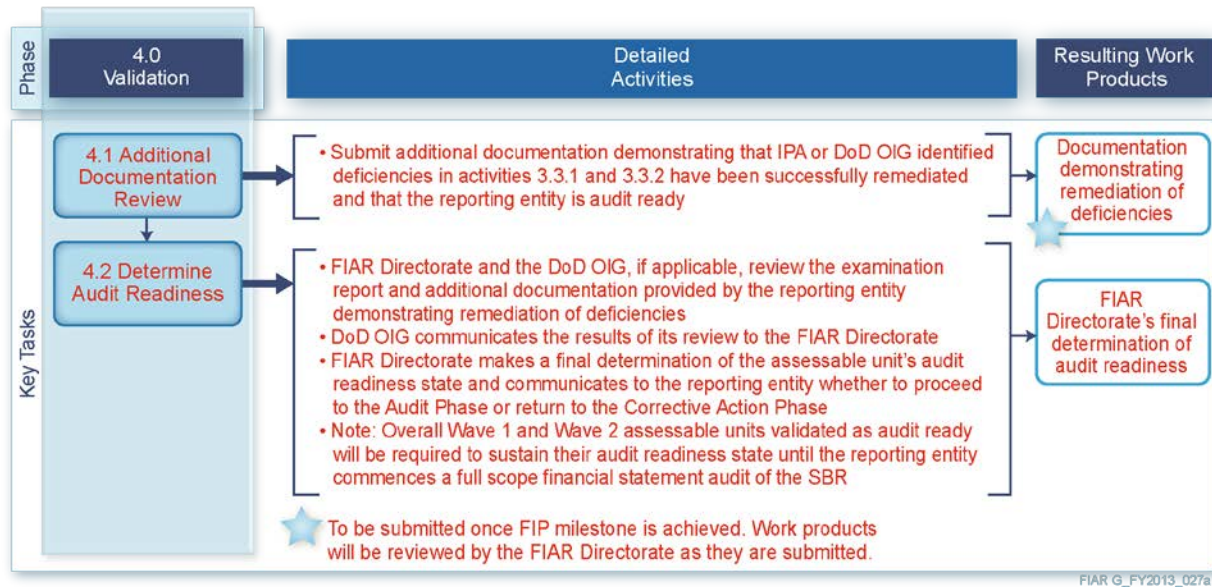


Figure 27. Validation Phase

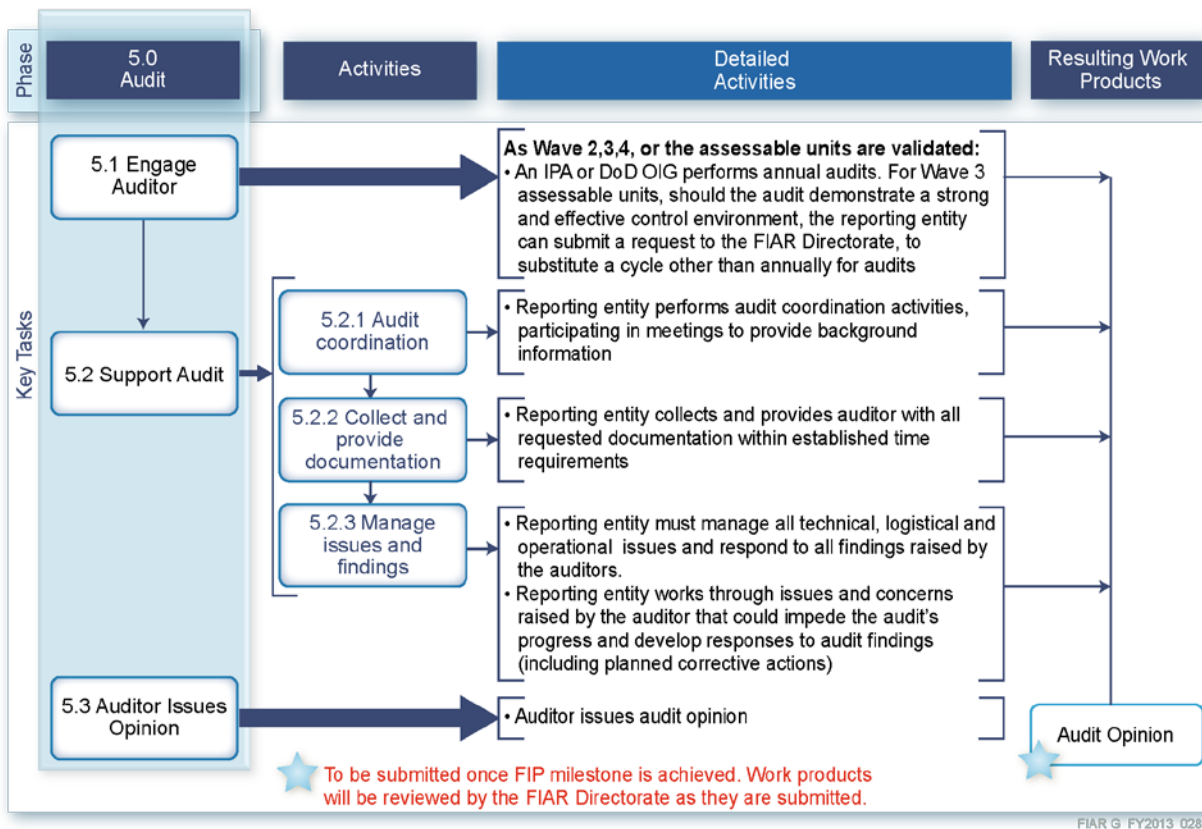


Figure 28. Audit Phase

3.A.6 Capabilities

GAGAS require auditors to collect evidence supporting the fair presentation of financial statement amounts by focusing on two primary areas: internal controls and supporting documentation. Therefore, to achieve audit readiness reporting entities must:

- Limit the risk of material misstatements by identifying and implementing a combination of control activities and supporting documentation to demonstrate that the FROs, relevant to the subject matter, assertion or processes, have been achieved, and
- Be able to support account transactions and balances with sufficient, relevant and accurate audit evidence, defined as KSDs in Appendix C, supplemented with the reporting entity's own documentation requirements.

To maximize the efficiency and effectiveness of audit readiness efforts, the Department has identified relevant financial statement assertion risks, **FROs** and supporting documentation required to substantiate financial transactions and balances by each of the four prioritized waves. For a full discussion of these requirements, see **Appendix C**.

Financial Reporting Objectives

FROs are the outcomes needed to achieve proper financial reporting and serve as a point of reference to evaluate the effectiveness of control activities and the accuracy and sufficiency of documentation supporting transactions and account balances. Reporting entities and service providers must include and address all FROs on their FIPs by focusing on:

INTERNAL CONTROLS

Effective internal controls mitigate risks and provide assurance that financial information is properly and accurately recorded and reported. They are critical to successful financial statement audits. **Effective internal controls:**

- Ensure that key risks are mitigated, and
- Are aligned with the financial statement assertions.

During the *Discovery Phase*, identifying and assessing the design and operational effectiveness of internal controls is necessary to understand and evaluate the effectiveness of operational business processes. **Internal controls must be documented and the documentation must be readily available to evidence execution of the control activity.** The documentation should be properly managed and maintained. The *Discovery Phase* includes assessments to identify inherent risks¹⁰ and testing control activities to identify weaknesses. CAPs are developed and implemented to remediate noted weaknesses and additional procedures are performed (**i.e., repetition of key tasks 1.3 and 1.4**) to verify successful implementation of corrective actions.

Reporting entities must indicate whether they have assessed control activities that meet FROs, and whether the control activities are effective. If they are not effective, then specific corrective action and validation tasks must be included in the reporting entity's FIP and linked to the appropriate **FRO**. By embedding the **FROs** in the FIPs and linking corrective actions to them, the Department is better assured that financial reporting deficiencies will be identified and resolved. Additionally, progress toward achieving reliable financial information and auditability can be better monitored, managed, and measured.

¹⁰ The GAO/PCIE *Financial Audit Manual*, Section 260: Identify Risk Factors, Paragraph .02, defines inherent risk as "the susceptibility of a relevant assertion to a misstatement that could be material, either individually or when aggregated with other misstatements, assuming that there are no related controls."

SUPPORTING DOCUMENTATION

Reporting entities must **identify and retain sufficient and accurate documentation to support individual financial transactions and accounting events prior to asserting audit readiness for the SBR and Existence and Completeness (E&C) waves.** Assessing the sufficiency and accuracy of supporting documentation is an essential FIP task and is a critical audit requirement for SBR and E&C audit readiness assertions. In fact, the Government Accountability Office/President's Council on Integrity and Sufficiency Financial Audit Manual (GAO/PCIE FAM) states that organizations must retain documentation to support:

1. Balances reported in the financial statements,
2. Systems of internal control,
3. Substantial compliance of the financial management systems with FFMIA requirements,
4. Substantial compliance of internal controls with FMFIA requirements,
5. Compliance with laws and regulations, and
6. Required supplementary information (RSI) including any stewardship information (RSSI).

The GAO/PCIE FAM also states that auditors performing financial statement audits must obtain sufficient evidential matter to form an opinion on an organization's financial statements.¹¹

Auditors must adhere to professional standards, which have been codified as Auditing Standards (AUs). AU 326, paragraph .04 notes, "Management is responsible for the preparation of the financial statements based upon the accounting records of the entity." **Appendix C** provides the KSD requirements for each prioritized wave of the Strategy.

Audit Readiness "Dealbreakers"

Drawing on lessons learned from past audit readiness efforts, the FIAR Directorate has compiled a list of dealbreakers that have prevented reporting entities from demonstrating audit readiness or succeeding in audits. **Figure 29** lists the most common dealbreakers and links each back to the detailed activities within the phases of the FIAR Methodology. During the Assertion/Evaluation phase, the FIAR Directorate will provide feedback to the reporting entity on the dealbreakers and recommend additional procedures to make improvements prior to an examination.

Dealbreakers	FIAR Guidance Reference
1. The general ledger does not reconcile to transaction detail, including support for all material journal vouchers related to the assessable unit.	Figure 18 , Discovery Phase, Task 1.4 Evaluate Supporting Documentation, Activity 1.4.1 Prepare the population.
2. Testing of transaction samples back to source documents that:	Figure 18 , Discovery Phase, Task 1.4 Evaluate Supporting Documentation, Activity 1.4.5 Test existence of supporting documentation.
a. Does not cover all material transaction types, sub- processes, and locations. b. Is not extensive enough to draw conclusions consistent with the effectiveness of controls. Specifically, if controls are ineffective, sufficient substantive testing (i.e., test of details performed through statistical or valid non-statistical sampling, or substantive analytical procedures) must be performed that would reduce the risk of material misstatements to an acceptable level, resulting in evidence that the balances are fairly stated.	Appendix D , Section D.3, Supporting Documentation Testing Section 3.C. Preparing for an Audit, Sub-section 3.C.1 Assertion Documentation

¹¹ Government Auditing Standards (Yellow Book) are the requirements for those performing Federal financial statement audits. The GAO/PCIE FAM is subordinate to Yellow Book requirements in the event conflicts arise.

Dealbreakers	FIAR Guidance Reference
3. All financial statement assertions and relevant risks are not addressed either through control or substantive testing.	Figure 16 , Discovery Phase, Task 1.2 Prioritize, Activity 1.2.4 Identify Financial Reporting Objectives Figure 17 , Discovery Phase, Task 1.3 Assess & Test Controls, Activity 1.3.3 Execute Tests of Controls Figure 18 , Discovery Phase, Task 1.4 Evaluate Supporting Documentation, Activity 1.4.5 Test existence of supporting documentation.
4. Reconciliations, transaction populations, and supporting documentation cannot be provided in a timely manner.	Section 3.C. Preparing for an Audit, Sub-section 3.C.1 Assertion Documentation
5. Control activities for high transaction volume areas (e.g., supply, contracts, FBWT, Inventory, OM&S, GE, etc.) are not designed and/or operating effectively.	Section 3.C. Preparing for an Audit, Sub-section 3.C.1 Assertion Documentation
6. IT general and application controls are not deemed effective and tested for management to rely on automated application controls or system generated reports (i.e., KSDs) from IT systems and/or micro- applications.	Section 3.C. Preparing for an Audit, Sub-section 3.C.1 Assertion Documentation
7. Supporting Documentation Testing (i.e., substantive testing) cannot overcome ineffective or missing ITGC and application controls when transaction evidence is electronic and only maintained within a system, or the key supporting evidence are system generated reports.	Section 3.C. Preparing for an Audit, Sub-section 3.C.1 Assertion Documentation
8. Service provider processes, risks, and controls are not integrated within scope of testing if those processes are material to the assessable unit.	Section 3.B.4 FIAR Methodology, Sub- section 3.B.4 Service Provider Methodology
9. Management has not established retrieval and storage procedures of financial data that will support management evaluation and future examinations/audits.	Figure 18 , Discovery Phase, Task 1.4 Evaluate Supporting Documentation, Activity 1.4.1. Prepare the Population.
10. Material Beginning Balances/Opening Balances are not evaluated through appropriate testing.	Figure 18 , Discovery Phase, Task 1.4 Evaluate Supporting Documentation.

Figure 29. Most Common Audit Readiness Dealbreakers

3.A.7 Standard FIP Framework

Recognizing the benefits from a standard FIP framework and content, the FIAR Directorate, working collaboratively with reporting entities, developed a standard framework and template for the FIPs. The framework incorporates the Methodology Phases and **FROs**, and is compatible with the Department's FIAR Planning Tool (FIAR-PT), which is a web-based software tool that provides DoD-wide access and visibility to the plans in a controlled environment.

Reporting entities and Service Providers (as necessary) are required by the standard FIP framework to include information that will improve their ability to manage their FIPs and the Department's ability to monitor progress indicators, examples include:

- Task start, finish, and baseline dates,
- Percent complete,
- Primary and secondary financial statement assertions,
- FIAR milestone designations¹²,
- Responsible person,
- End-to-end process indicators,
- Lead and support organization designations, and
- Resource requirements to include level of effort to complete and level of effort committed.

¹² It should be noted that reporting entities will also be meeting OMB Circular A-123, Appendix A milestones as part of their efforts for meeting the FIAR methodology milestone dates.

Reporting entities and service providers must use the standard FIP framework, regardless of their audit ready status, (i.e., under audit or preparing for audit). The FIPs are living documents and must be maintained and updated as reporting entities progress through the phases/tasks/activities of the Methodology. Although the sequence of the information included in the standard FIP template may be altered, all required information must be included. FIP dates will be used to update the FIAR Plan Status Report, which serves as the Department's annual Financial Management Improvement Plan, required by Section 1008(a) of the NDAA for FY 2002, to address the issues preventing the reliability of Department financial statements. See FIAR Guidance website for the [standard FIP template](#) and [FIP Preparation and Submission Instructions](#) document.

3.B FIAR METHODOLOGY – SERVICE PROVIDER

Reporting entities are responsible for ensuring that all key processes, systems, internal controls and supporting documentation impacting their financial reporting objectives are audit ready. However, as shown in **Figure 30** service providers working with reporting entities are also responsible for executing audit readiness activities surrounding service provider systems and data, processes and internal controls, and supporting documentation that have a direct effect on reporting entities' audit readiness state.

To successfully prepare for audit, reporting entities must coordinate with their service providers to formalize their relationships, prepare documentation illustrating the financial reporting aspects of their operations through end- to-end business processes, and identify/evaluate control activities and supporting documentation over those processes impacting the reporting entities financial reporting objectives. Service providers must also establish an infrastructure for supporting the reporting entities' financial statement audits. They can do so by:

- Undergoing an examination in accordance with the Statement on Standards for Attestation Engagements (SSAE) No. 16, where the auditor reports on internal controls at service providers that provide services to reporting entities when those controls are likely to be relevant to reporting entities' internal control over financial reporting
- Directly participating in and supporting the reporting entity's financial statement audit, where the service provider's processes, systems, internal controls and supporting documentation are audited as part of the reporting entity's audit.

Normally it is inefficient for both the entity under audit and the service provider to have the financial statement auditor separately audit the service provider's controls and supporting documentation. The general practice is for the service provider to undergo an examination in accordance with the SSAE No. 16¹³ on the service provider's controls. An SSAE No. 16 report includes the following three sections:

1. Section 1 – Service Auditor's Report
2. Section 2 – Management's Description of its system(s) and Management's Assertion
3. Section 3 – Control Objectives, Control Activities and Tests of Operating Effectiveness

The reporting entity's financial statement auditor can rely on the SSAE No. 16 examination opinion, which reduces the nature and extent of internal control and substantive testing (i.e., supporting documentation testing) required for the financial statements audit. From the perspective of the service provider, the primary benefit of obtaining an SSAE No. 16 examination report is not having extensive interaction with multiple reporting entity auditors, each evaluating and testing the service provider's controls separately.

The process for eliminating audit impediments and known service provider exceptions is to follow the Service Provider Methodology whereby the service provider evaluates the design and operating effectiveness of control activities, and corrects material deficiencies before an SSAE No. 16 examination begins. The Service Provider Methodology incorporates the inter-relationships between the reporting entity's end-to-end processes and the service provider's processes, systems, controls, transactions and

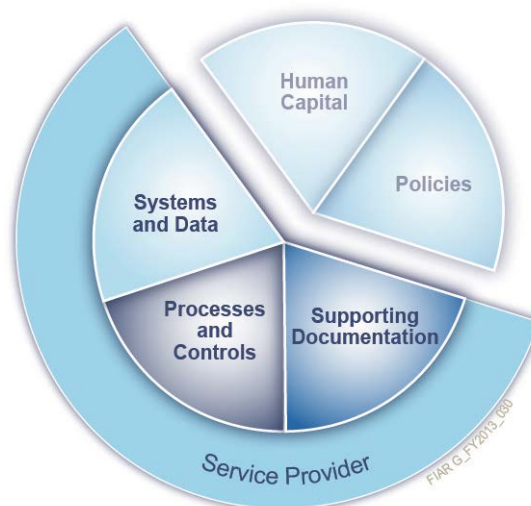


Figure 30. Service providers are responsible for the systems and data, processes and internal controls, and supporting documentation that affect a reporting entity's audit readiness

¹³ SSAE No. 16 superseded Statement on Auditing Standard (SAS) No. 70, effective for reports with an issue date of June 15, 2011 or later.

documentation. For example, **Figure 31** provides a notional illustration of the Civilian Pay end-to-end process. The illustration depicts the processes, systems, internal controls, and documentation within both the reporting entity and the service provider. Note that control activities may be manual or automated and documentation may be retained by either entity. In addition, transactions may be executed within either the reporting entity portion of the process or service provider portion of the process. **Therefore, both organizations must be able to provide supporting documentation to demonstrate that control activities are properly designed and operating effectively and transactions are properly posted to the accounting records.**

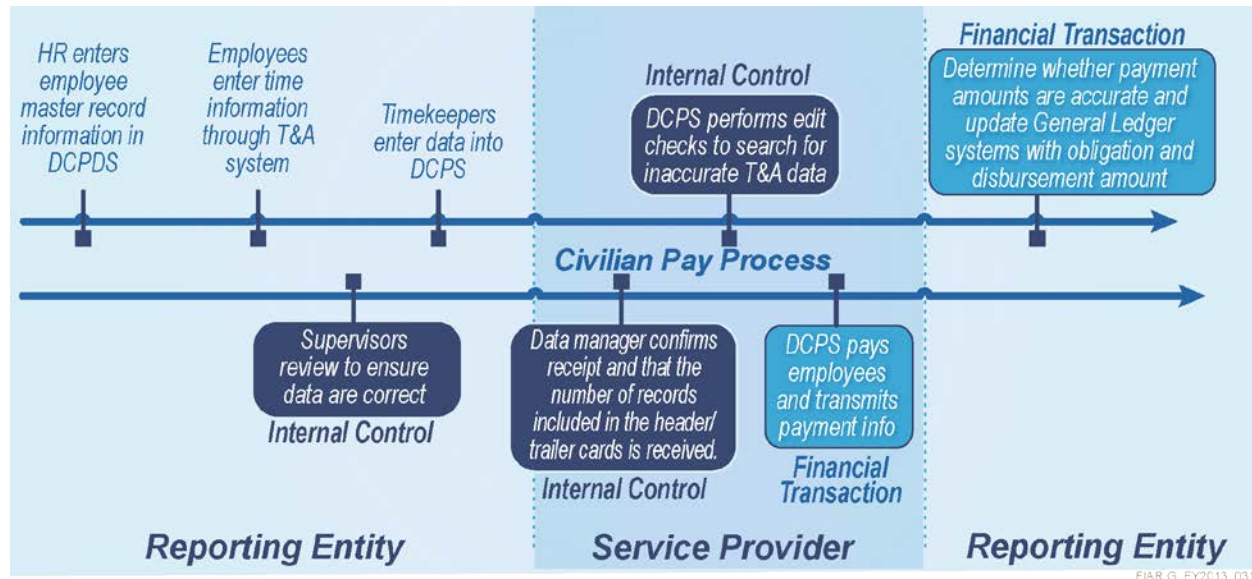


Figure 31. Reporting entities and service providers are responsible for different segments of end-to-end processes in the Department

3.B.1 Definitions

The following SSAE No. 16 definitions facilitate the discussion of the Service Provider Strategy and Methodology that follows:

- **Reporting Entity** – The entity that has outsourced business tasks or functions to other entities (service providers) and is either working to become audit ready or is undergoing an audit of its financial statements.
- **Service Provider** – The entity (or segment of an entity) that performs outsourced business tasks or functions for the reporting entity that are part of the reporting entity's manual and/or automated processes for financial reporting.
- **User Auditor** – The financial statement auditor who issues an opinion report on the financial statements of the reporting entity.
- **Service Provider Auditor (Service Auditor)** – The auditor who is retained by the service provider to issue an opinion on the service provider's controls that are relevant to a reporting entity's internal control over financial reporting as it relates to an audit of the reporting entity's financial statements (e.g., SSAE No. 16 examination report).

In addition to the SSAE No. 16 service provider definitions, the Department has designated executive agents as service providers. DoDI5101.1 "DoD Executive Agent" section 3.1, defines an executive agent as "the head of a DoD Component to whom the Secretary of Defense or the Deputy Secretary of Defense has assigned specific responsibilities, functions, and authorities to provide defined levels of support for operational missions, or administrative or other designated activities that involve two or more of the DoD Components." An example of an executive agent is an entity (or segment of an entity) that owns an information system and runs that system on behalf of a reporting entity (e.g. the DCPAS maintains the

Department's civilian Personnel system (DCPDS) software, which is used to initiate, approve, and process personnel actions for reporting entity civilian employees). Because Departmental executive agents are service providers, they must follow the Service Provider Methodology.

3.B.2 Relationship to Waves

The DoD Components include both reporting entities and service providers. The Department utilizes many service providers to improve efficiency and standardize business operations. Examples of service providers within the Department include the Defense Finance and Accounting Service (DFAS), Defense Information Systems Agency (DISA), Defense Logistics Agency (DLA), Defense Contracts Management Agency (DCMA), and Defense Civilian Personnel Advisory Service (DCPAS). These service providers provide a variety of accounting, personnel, logistics, or system development or operations/hosting support services.

The following table illustrates the most common service providers for each wave of the FIAR strategy. Please note that the table does not contain a complete listing of the Department's service providers.

WAVES 2 & 3 SERVICE PROVIDERS	
Service Providers	Description of Services Provided
Wave 2 – Statement of Budgetary Resources	
<i>CIVILIAN PAYROLL</i>	
DCPAS	DCPAS maintains DCPDS, or the Department's civilian Personnel system software, which is used to initiate, approve, and process personnel actions for reporting entity civilian employees. Additionally, for reporting entities other than the Military Services, DCPAS hosts the personnel system at a DCPAS managed data center. Accordingly, reporting entities rely on the system (including relevant system control activities) to ensure the completeness, accuracy, validity, and restricted access to civilian personnel actions.
DFAS	DFAS calculates bi weekly civilian pay using personnel data obtained from the personnel system, combined with time and attendance information passed from reporting entity systems. In addition to calculating the bi- weekly payroll, DFAS also disburses the bi-weekly pay for reporting entities through direct deposit or check. The DFAS also records the bi weekly pay accounting transactions in the general ledger for some reporting entities. The services performed by DFAS represent a large portion of the civilian pay activity; therefore, reporting entities are relying on DFAS processes, systems, and control activities for a large portion of their civilian payroll process.
DISA	DISA hosts applications for the Department's service providers and reporting entities. Specific to civilian pay, DISA hosts DFAS pay processing and disbursing applications, as well as some of the reporting entity time and attendance and general ledger applications. As a result, DISA is responsible for most of the Information Technology General Controls (ITGCs) over the environment in which these key applications reside. For service providers and reporting entities to rely on the automated control activities and documentation within these applications, it is essential for the ITGCs to be appropriately designed and operating effectively.
<i>MILITARY PAYROLL</i>	
DFAS	DFAS processes the bi-monthly military pay using personnel data obtained from the Military Service's personnel systems. In addition to calculating the bi-monthly pay, DFAS also disburses the pay for military personnel through direct deposit or check. DFAS also records the bimonthly accounting transactions in the Military Departments' general ledger. DFAS performed services represents a large portion of the military pay activity; therefore, the Military Services are relying on DFAS processes, systems, and controls for a large portion of their military pay process.
DISA	DISA hosts applications for the Department's service providers and the Military Services. Specific to military pay, DISA hosts DFAS pay processing and disbursing applications, as well as some of the Military Services' general ledgers applications. As a result, DISA is responsible for most of the Information Technology General Controls (ITGCs) over the environment in which these key applications reside. For the service providers and Military Services to rely on the automated controls and documentation within these applications, it is essential for the ITGCs to be appropriately designed and operating effectively.
<i>CONTRACT & VENDOR PAY</i>	
DLA	DLA maintains the Department's contract writing and invoice or receipt processing systems used to initiate, approve, and process contracts and invoices. Accordingly, reporting entities rely on these systems, including their relevant system control activities, to help ensure the completeness, accuracy, validity, and restricted access for contracts and invoicing and receipt activity.

WAVES 2 & 3 SERVICE PROVIDERS	
DCMA	DCMA maintains the Department's contract management system in coordination with DFAS that is used to manage the Department's largest contracts from inception to closeout. Accordingly, reporting entities rely on this system, including relevant system control activities, to help ensure the completeness, accuracy, validity, and restricted access for contracts management activity. In addition to maintaining Department systems, DCMA monitors contractor performance and management systems to ensure that cost, product performance, and delivery schedules comply with the terms and conditions of the contracts.
DFAS	DFAS performs the entitlement and disbursement functions of contract and vendor pay for the reporting entities. In addition, DFAS also records the contract and vendor pay accounting transactions in the general ledgers for some reporting entities. Accordingly, reporting entities rely on DFAS entitlement and disbursement processes and systems, including the relevant system control activities, to help ensure the completeness, accuracy, validity, and restricted access for contract disbursements and accounting.
DISA	DISA hosts applications for the Department's service providers and reporting entities. As a result, DISA is responsible for most of the Information Technology General Controls (ITGCs) over the environment in which these key applications reside. In order for the service providers and reporting entities to rely on the automated control activities and documentation within these applications, it is essential for the ITGCs to be appropriately designed and operating effectively.

WAVE 3 – EXISTENCE & COMPLETENESS OF ASSETS	
DLA	DLA provides almost all consumable items needed by the Military Services to operate, from food, fuel, and energy to uniforms, medical supplies, and construction and barrier equipment. DLA also supplies the majority of the Military Services spare parts and manages the reutilization of military equipment. Accordingly, the Military Services rely on DLA processes and systems, including relevant system control activities, to help ensure the completeness, accuracy, validity, and restricted access for certain military equipment, inventory, and operating materials and supplies.
DISA	DISA hosts applications for the Department's service providers and reporting entities. As a result, DISA is responsible for most of the Information Technology General Controls (ITGCs) over the environment in which these key applications reside. For service providers and reporting entities to rely on the automated control activities and documentation within these applications, it is essential for the ITGCs to be appropriately designed and operating effectively.

3.B.3 Strategy

Figure 32 presents a decision tree that a service provider must use to determine how it will approach service provider audit readiness at an assessable unit (See Section 3.A.3 for more detailed information on assessable units) level.

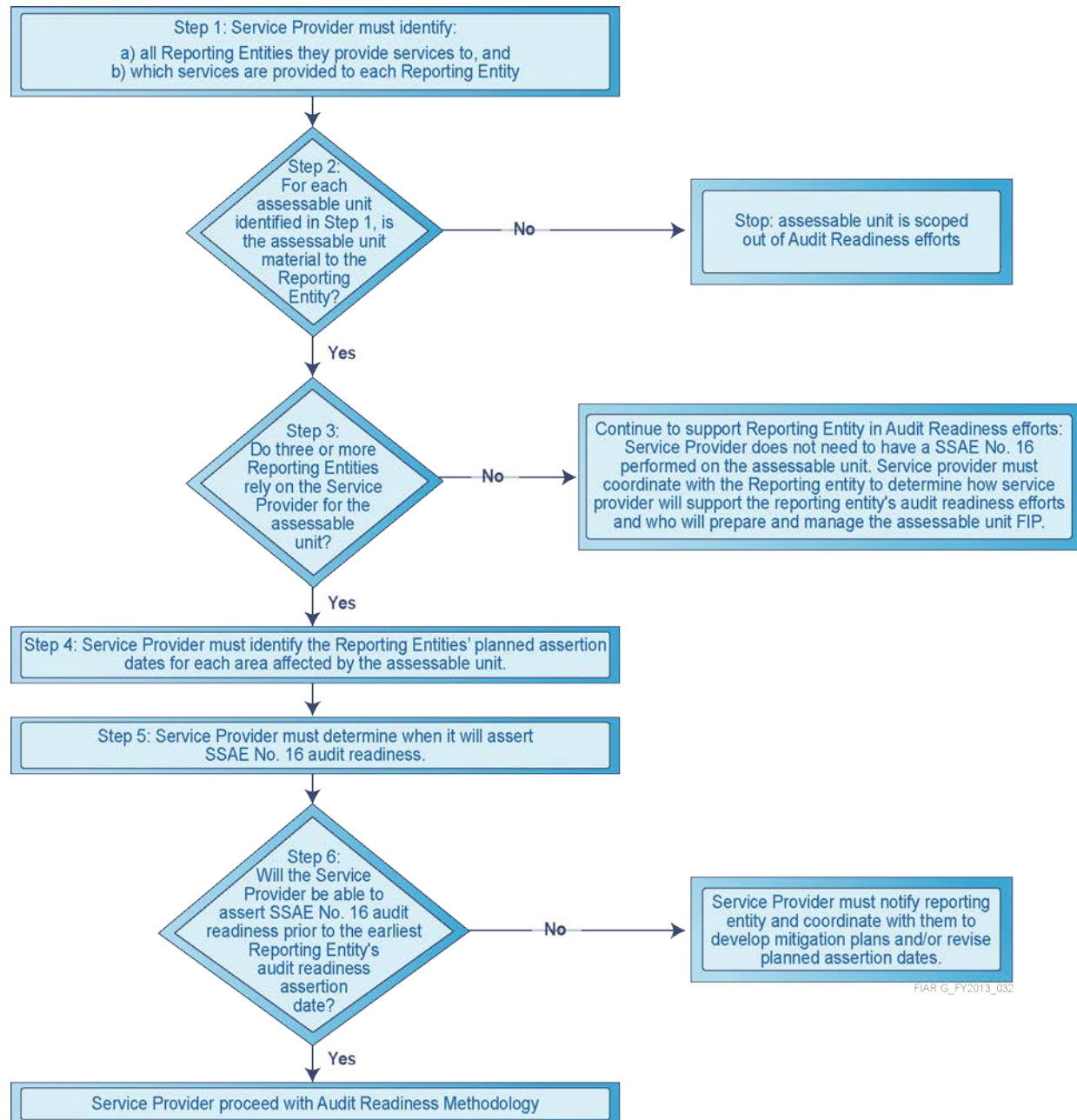


Figure 32. Service Provider Decision Tree for Determining Approach to Audit Readiness

As service providers work to become audit ready, they must focus on the following key factors:

- The reporting entity is responsible for the processes, systems, internal controls, transactions, and documentation to support its financial reporting assertions and audit readiness efforts.
- The reporting entity must communicate with its service provider to understand the scope of the service provider's processes, systems, internal controls, and documentation that are material to the reporting entity's financial reporting objectives, and therefore, may require an SSAE No. 16 examination.

The service provider and the reporting entity must work together to:

1. Maintain open communications and coordinate with each other and their supporting contractors;
2. Provide additional system and financial information within agreed upon timeframes; and
3. Provide access to subject matter experts or contractors supporting those organizations in agreed upon timeframes.

The reporting entity and service provider must agree on the roles and responsibilities for the authorization, initiation, processing, recording and reporting of transactions affected by the service provider, including requirements for the retention of supporting documents and must document this within a Memorandum of Understanding (MOU). The MOU also identifies the supporting documentation that should be retained for each business process and transaction type, the organization that will retain the specific documents, and specifies the retention period for the documentation. **The service provider must provide a description of its internal controls that may affect the reporting entity's control environment, risk assessment, control activities, information and communication, or monitoring of the reporting entity's internal control. The description of internal controls should be at a level of detail that provides user auditors with sufficient information to assess the risks of material misstatement,** but need not address every aspect of the services provided to the reporting entity. Refer to **Appendix D** for additional information on entity level controls.

- Per the American Institute of Certified Public Accountants (AICPA) Implementation Guidance, the SSAE No. 16 specifically states that SSAE No. 16 is not applicable when the service auditor is reporting on controls at a service provider that are not relevant to reporting entities' internal controls over financial reporting (ICOFR), such as controls related to regulatory compliance or privacy. For audit readiness purposes, the service provider is not required to provide the reporting entity with an SSAE No. 16 report on controls that are not relevant to ICOFR. As described below in "Types of Service Organization Control (SOC) reports", the service provider has three options when deciding on the SOC report to obtain. The SOC 1 report is the most common type of SSAE No. 16 report used and is required for financial statement audit readiness purposes. If the reporting entity requests information on compliance or regulatory controls not related to ICOFR and the service provider has not completed a SOC 2 or SOC 3 report, the service provider may provide the reporting entity with results from their internal reviews, such as the Department of Defense Information Assurance Certification and Accreditation Process (DIACAP), Federal Information Security Management Act (FISMA), or FFMIA reviews.
- Service providers must prepare, evaluate, and remediate weaknesses in their processes, systems, internal controls and supporting documentation to effectively support the reporting entity audit. This requires the service provider to understand the reporting entity's audit readiness timeline, and coordinate its audit readiness activities with those of the reporting entity prior to engaging an IPA to perform an SSAE No. 16 examination. Coordination and communication between the service provider and reporting entity is essential throughout the audit readiness process.
- The service provider must execute the Methodology.
- Service providers with three or more customers must initiate an SSAE No. 16 examination that covers at least six months of the customer's audit period. Service providers with two or fewer customers must continue to support their reporting entity customer audit readiness efforts

but are not required to undergo an SSAE No. 16 examination of the assessable unit. The service provider must coordinate with its customers to ensure all required audit readiness activities are fully and accurately captured in the reporting entity FIPs. In this circumstance, the service provider must also be ready to support the testing that will be performed by the customer's external auditors during the actual financial statement audit.

- The service provider has lead responsibility for coordinating SSAE No. 16 attestation engagements of its processes and internal controls by completing the steps in **Figure 32**.
- Because of the complexities inherent in DoD reporting entity and service provider relationships and associated audit readiness interdependencies, it is essential that a common, detailed understanding of the method for obtaining assurance (SSAE No. 16 examination or supporting the customer audit readiness efforts), scope, roles, responsibilities, required FIAR deliverables, and timeline be established. Accordingly, the service provider and reporting entity shared understanding and agreement on these essential elements must be documented in a Service Level Agreement (SLA) or MOU. In addition to defining the essential audit readiness approach for obtaining assurance, scope, roles, responsibilities, required FIAR deliverables, and timeline, the SLA or MOU will also specify whether the service provider and/or executive agent will prepare its own FIP or whether its audit readiness activities will be included in the reporting entity FIP.
- The service provider and reporting entity must work together to discover and correct audit impediments.

Types of Service Organization Control (SOC) Reports

In response to the evolving assurance needs of service organization customers, the AICPA has responded by designing multiple Service Organization Control (SOC) reports. The reports are based on AICPA Statement on Standards for Attestation Engagements (SSAE) No. 16 and Trust Services (AT 101).

Each type of SOC report has been purposefully developed to address a specific assurance need, for example, internal controls that affect user entities' financial reporting or internal controls that affect the security, availability, and processing integrity of the systems or the confidentiality or privacy of the information processed for user entities' customers. The applicable SOC report will vary depending on the subject matter.

The SOC 1 Report is the report that should be used for the purpose of satisfying FIAR requirements for Audit Readiness, as it provides an opinion on the suitability of the design and operating effectiveness of controls impacting user entities' financial reporting.

1. SOC 1 Report – Report on Controls at a Service Organization Relevant to User Entities' Internal Control over Financial Reporting

These reports, prepared in accordance with SSAE No. 16, are specifically intended to meet the needs of the reporting entities that use service providers and the reporting entity's auditors. The SOC 1 report is used in evaluating the effect of the controls of the service provider on the reporting entity's financial statements. SOC 1 is a report on internal controls at a service provider which are relevant to the reporting entities' internal controls over financial reporting. SOC 1 reports do not address non-financial reporting-related controls.

The SSAE No. 16 Guidance allows for either a Type 1 Report or a Type 2 Report.

- a. SOC 1 – Type 1 Report – Report on Management's Description of a Service Organization's System and the Suitability of Design of Controls

These reports encompass:

- the service auditor's report in which the service auditor expresses an opinion on:
 - the fairness of the presentation of management's description of the service organization's system,

- the suitability of the design of the controls to achieve the related control objectives included in the description as of a specified date, and
 - objectives included in the description as of a specified date.
 - management’s description of the service organization’s system, and
 - management’s written assertion
- b. SOC 1 – Type 2 Report – Report on Management’s Description of a Service Organization’s System and the Suitability of the Design and Operating Effectiveness of Controls**

These reports encompass:

- the service auditor’s report in which the service auditor expresses an opinion on:
 - the fairness of the presentation of management’s description of the service organization’s system and
 - the suitability of the design and the operating effectiveness of the internal controls to achieve the related control objectives included in the description throughout a specified period.
- management’s description of the service organization’s system
- management’s written assertion

The FIAR Directorate requires service providers to obtain Type 2 reports as these reports provide an opinion on both the design and operating effectiveness of internal controls. Since the Type 2 report is the recommended and more commonly used of the SOC reports, when a SOC 1 report is discussed in the remainder of the guidance it is referring to the Type 2 report.

2. SOC 2 Report – Report on Controls at a Service Organization Relevant to Security, Availability, Processing Integrity, Confidentiality or Privacy

These reports are intended to meet the needs of a broad range of users that need information and assurance about the controls at a service organization that affect the security, availability, and processing integrity of the systems the service provider uses to process the reporting entity’s data and the confidentiality and privacy of the information processed by these systems. The SOC 2 reports are performed in accordance with, and are based upon Attestation Standard (AT) 101, “Attest Engagements”. AT 101 is governed by the AICPA and establishes the framework for controls and non-financial attest work. These reports are for compliance purposes and are not required for audit readiness purposes.

3. SOC 3 Report – Trust Services Report for Service Organizations

These reports are designed to meet the needs of users who need assurance about the controls at a service provider that affect the security, availability, and processing integrity of the systems used by the service provider to process the reporting entity’s information and the confidentiality, or privacy of that information but do not have the need for or the knowledge necessary to make effective use of a SOC 2 Report. Similar to the SOC 2 report, the SOC 3 report is based upon the Trust Service Principles and performed under AT 101, the difference being that a SOC 3 report can be general use distribution and only reports on whether the entity has achieved the Trust Services criteria or not. These reports are for compliance purposes and are not required for audit readiness purposes.

Carve-Out Method Requirements

Per the SSAE No. 16 Guidance published by the AICPA, a service provider may use the carve-out method to present information about the services provided by the subservice organization in its description of the subservice organization’s system. The carve-out method is used by the service provider’s management to identify the nature of the services provided by a subservice organization, but excludes the subservice organization’s relevant control objectives and related internal controls from the description and scope of the service provider’s SSAE No. 16 report. DISA is an example of a DoD

subservice provider, providing application hosting services for the Defense Civilian Pay System (DCPS) Civilian Pay application.

If the service provider plans to use the carve-out method, additional actions must be performed by the service provider to ensure that all required internal controls are covered by either the service provider or the subservice provider organization (as required by OMB Bulletin No. 07-04, Section 6). When using the carve-out method, management of the service provider would carve-out those control objectives for which related internal controls operate only or mostly at the subservice organization. However, management of the service organization is responsible for communicating with the subservice organization to ensure that the control objectives and related internal controls that they plan to carve-out are being separately evaluated by the subservice organization and are operating effectively¹⁴. Management must also be aware that per the SSAE No. 16, the service provider is expected to provide a description of internal controls they have in place to monitor certain key activities and internal controls performed by the subservice organization.

When the carve-out method is used, management's description of the service provider's system should include the nature of the services performed by the subservice organization, but will exclude the subservice organization's relevant control objectives and related internal controls. The description of the service provider's system carves out those control objectives for which related internal controls operate only or primarily at the subservice organization. However, the description would contain sufficient information concerning the carved-out services to enable the user auditor to understand what additional information the service auditor needs to obtain from the subservice organization to assess the risk of material misstatement of the reporting entity's financial statements. The service provider will include all available subservice organization SSAE No. 16 reports in their assertion documentation.

When using the carve-out method, instances may exist in which achieving one or more control objectives depends on one or more controls performed by a subservice organization. In such instances, management's description of its system would identify the controls performed at the service provider and indicate that the related control objectives would be achieved only if the subservice organization's controls were suitably designed and operating effectively throughout the period. The service provider may include a table in its description that identifies those instances in which control objectives are met solely by the service provider and those in which controls at the service provider and at the subservice organization are needed to meet the control objective. Communication between the service provider and the subservice organization, as well as a documented SLA or MOU is essential to ensure that all controls needed are covered.

If a service provider cannot successfully prepare and undergo a SSAE No. 16 within the required timeframe, it should notify its customers (reporting entities) immediately so that customers and the service provider can work on mitigation plans and/or revise planned FIP milestone dates for this key audit readiness dependency, and then notify the FIAR Directorate of these changes.

3.B.4 Methodology – Service Provider Methodology

Service providers are responsible for the initiation, authorization, recording, processing or reporting of financial transactions on behalf of the reporting entity. Service providers must have effective processes and control activities to assist the reporting entity in meeting its financial reporting objectives. Consequently, service providers play a key role in ensuring that the reporting entity achieves audit readiness. This section of the Guidance describes the Department's methodology that service providers must follow to support their customers' work to achieve audit readiness, as well as Departmental efforts to develop a common strategy by bringing together service providers and reporting entities to identify risks, develop common control and financial reporting objectives, and ensure control activities are designed to meet those risks and are operating effectively.

The following figure (**Figure 33**) presents the FIAR methodology that service providers must follow to assist the reporting entity in achieving audit readiness.

¹⁴ Adopted from OMB Bulletin 07-04, paragraph 6.17.

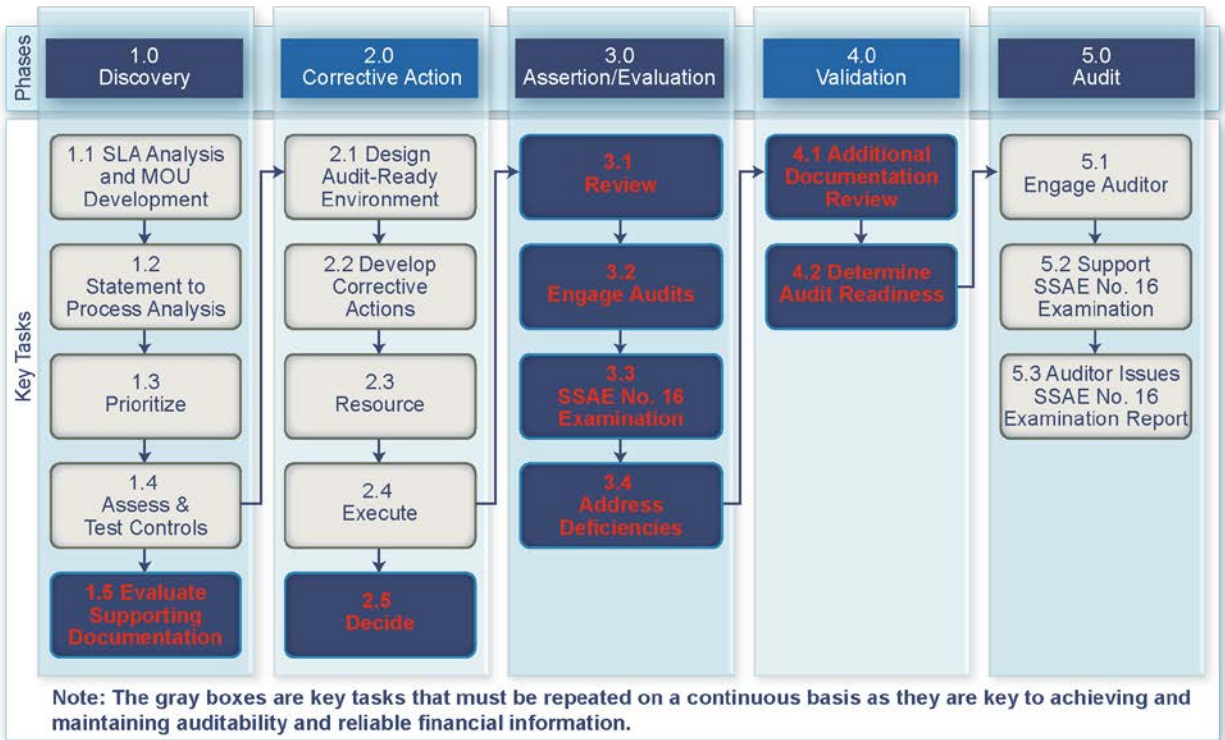


Figure 33. Service Provider Phases and Key Tasks to Achieve Auditability and Reliable Financial Information

3.B.5 Phases and Key Tasks

The phases and key tasks of the Methodology are as follows:

1. Discovery:

- Service provider coordinates with the reporting entity to document understanding of roles and responsibilities within the service level agreement (SLA) or Memorandum of Understanding (MOU)
- Service provider documents its business processes and the financial environment
- Service provider defines and prioritizes its processes into assessable units
- Service provider identifies risks, financial reporting objectives and control activities, and tests the design and operational effectiveness of control activities
- Service provider evaluates the sufficiency and accuracy of documentation to support financial transactions, account balances and financial statement line items
- Service provider identifies and classifies any weaknesses in control activities and/or supporting documentation

2. Corrective Action:

- Service provider defines and designs audit readiness environment, to include requirements for remediating deficiencies in internal control and supporting documentation
- Service provider develops concrete corrective action plans to resolve each deficiency identified during the Discovery phase
- Service provider develops budget estimates of required resources (i.e., funding and staffing levels) to execute corrective actions

- d. Service provider executes corrective action plans and verifies that corrective actions were implemented
- e. Service provider determines strategy for supporting reporting entity's audit readiness efforts (i.e., proceed with SSAE No. 16 examination or be audited as part of reporting entity's financial statement audit)

3. Assertion/Evaluation

- a. FIAR Directorate evaluates documentation to determine audit ready state and provides feedback to the service provider on its status of audit readiness.
- b. Service provider provides a management assertion letter on the fairness of the description of its system, the suitability of the design of controls, and the operating effectiveness of controls to meet control objectives
- c. Service provider engages an auditor to perform SSAE No. 16 examination
- d. Service provider evaluates nature and extent of deficiencies noted and implements corrective actions to remediate deficiencies
- e. Service provider performs procedures to verify that corrective actions successfully remediated auditor identified deficiencies
- f. Service provider submits SSAE No. 16 examination report, and additional documentation demonstrating successful remediation of auditor identified deficiencies to the FIAR Directorate and DoD OIG

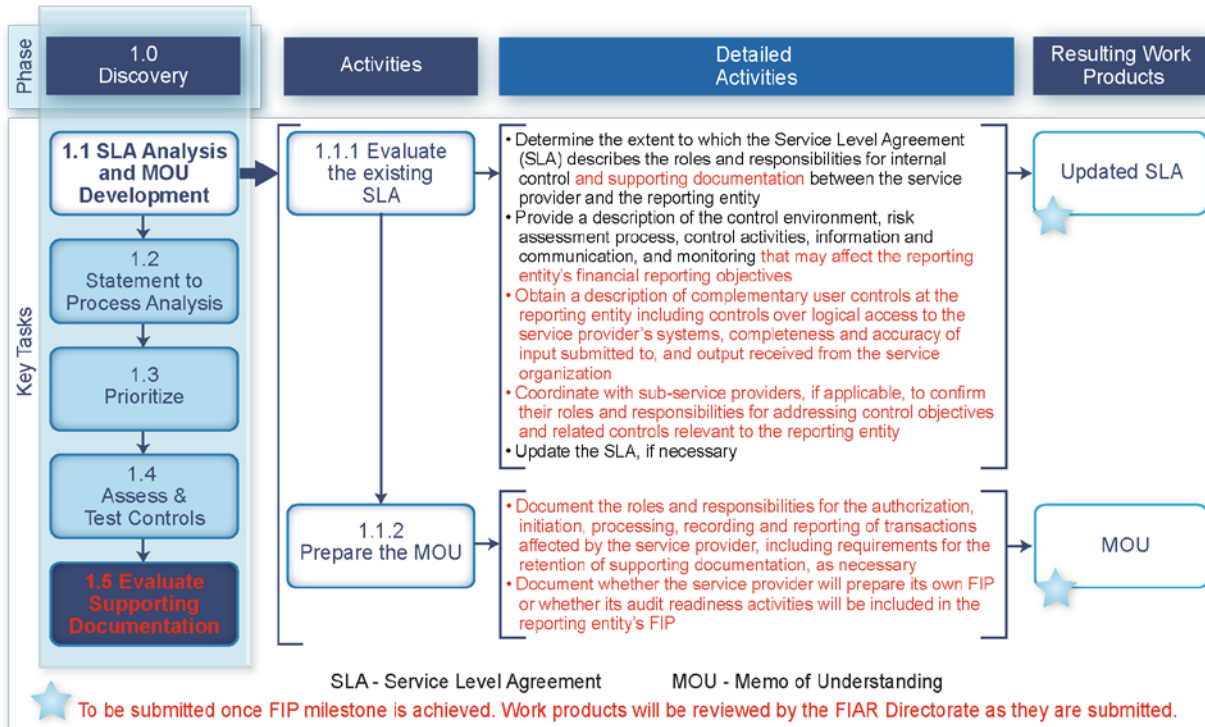
4. Validation

- a. FIAR Directorate reviews SSAE No. 16 examination report and additional documentation supporting successful remediation of deficiencies, and
- b. determine service provider's audit readiness state

5. SSAE No. 16 Examination

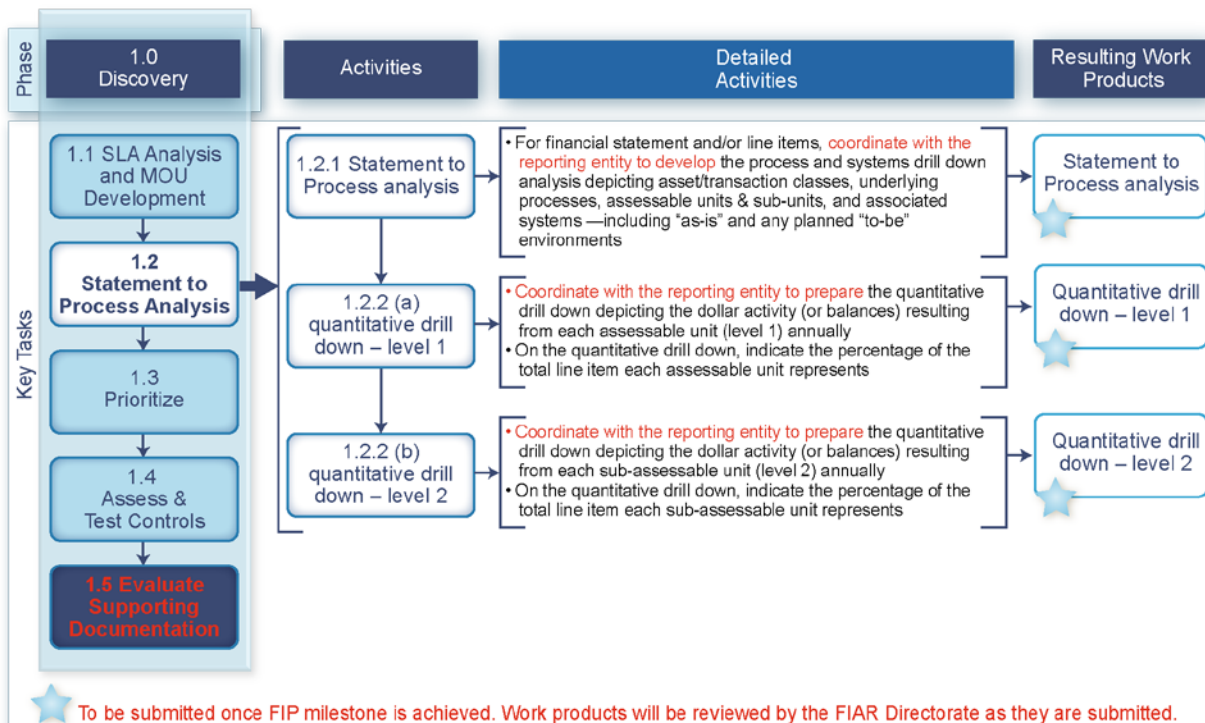
- a. Service provider engages auditor to perform SSAE No. 16 examination
- b. Service provider supports the SSAE No. 16 examination
- c. Auditor issues SSAE No. 16 examination report

The key tasks are numbered to coincide with the standard FIP Template. For example, the Discovery Phase of the FIP template includes key tasks beginning with section 1.1, while the Audit Phase begins with section 5.1 of the template.



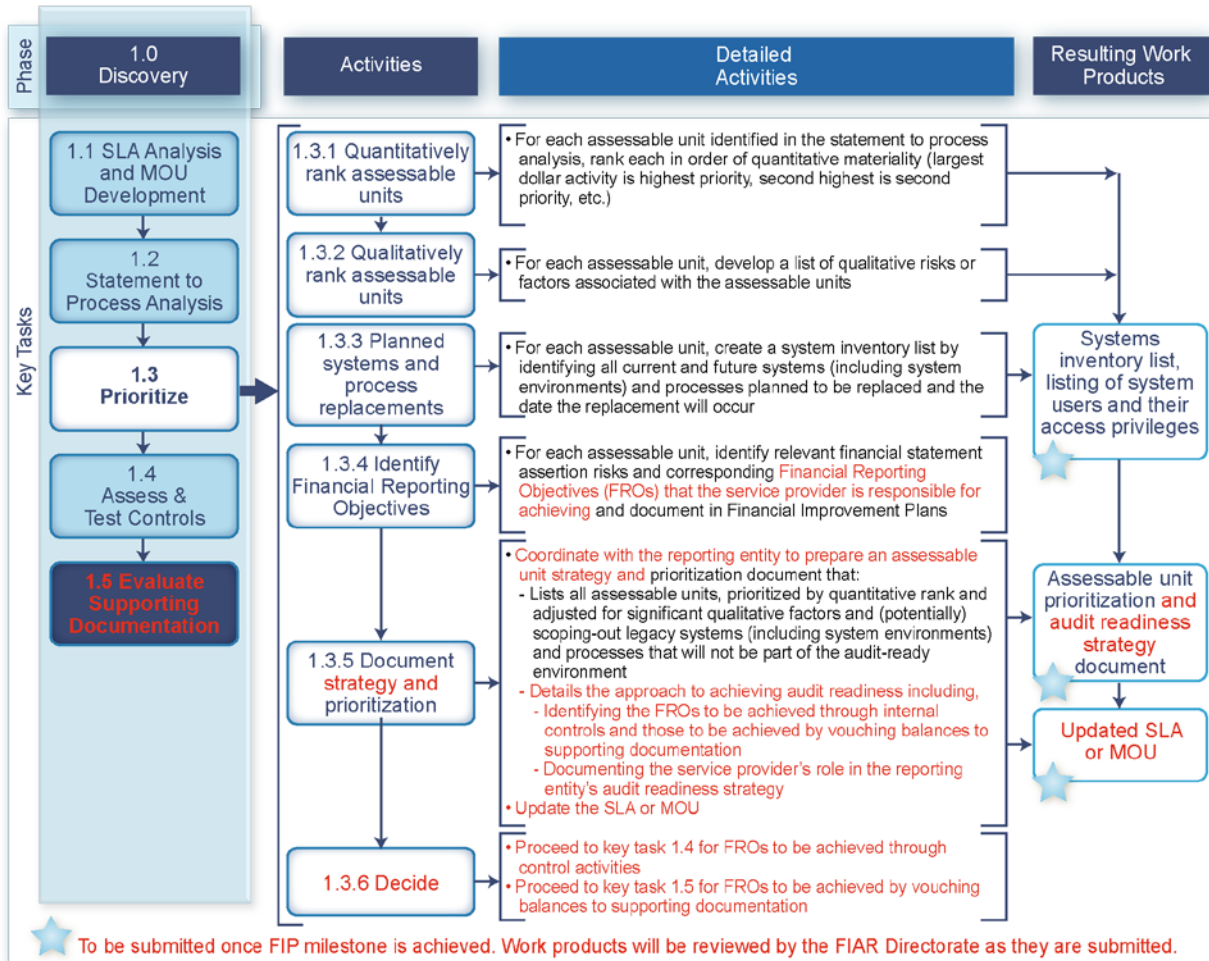
FIAR G_FY2013_034a

Figure 34. Discovery Phase – SLA Analysis and MOU Development



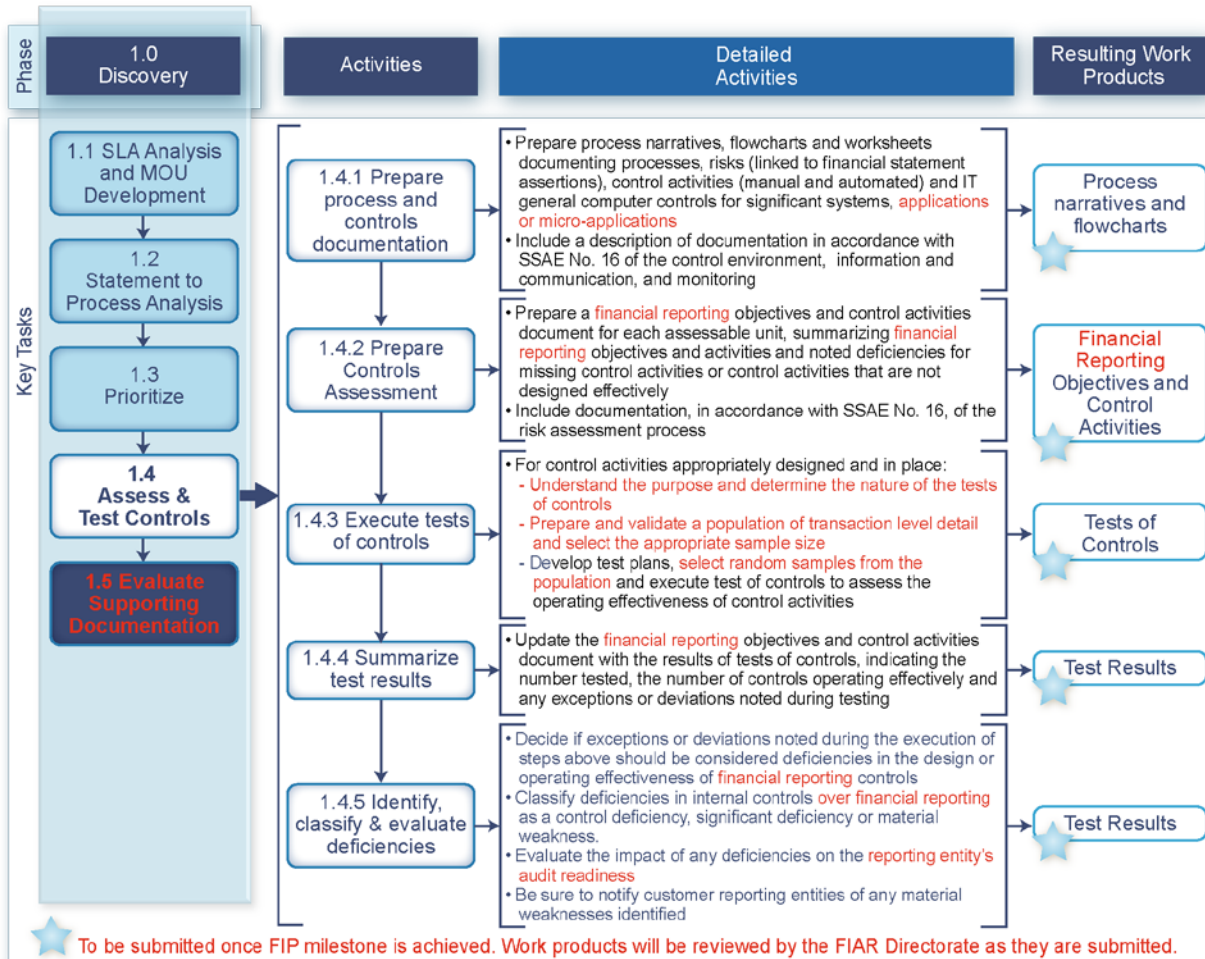
FIAR G_FY2013_035a

Figure 35. Discovery Phase – Statement to Process Analysis



FIAR G. FY2013_036a

Figure 36. Discovery Phase – Prioritize



FIAR G_FY2013_037a

Figure 37. Discovery Phase – Assess & Test Controls

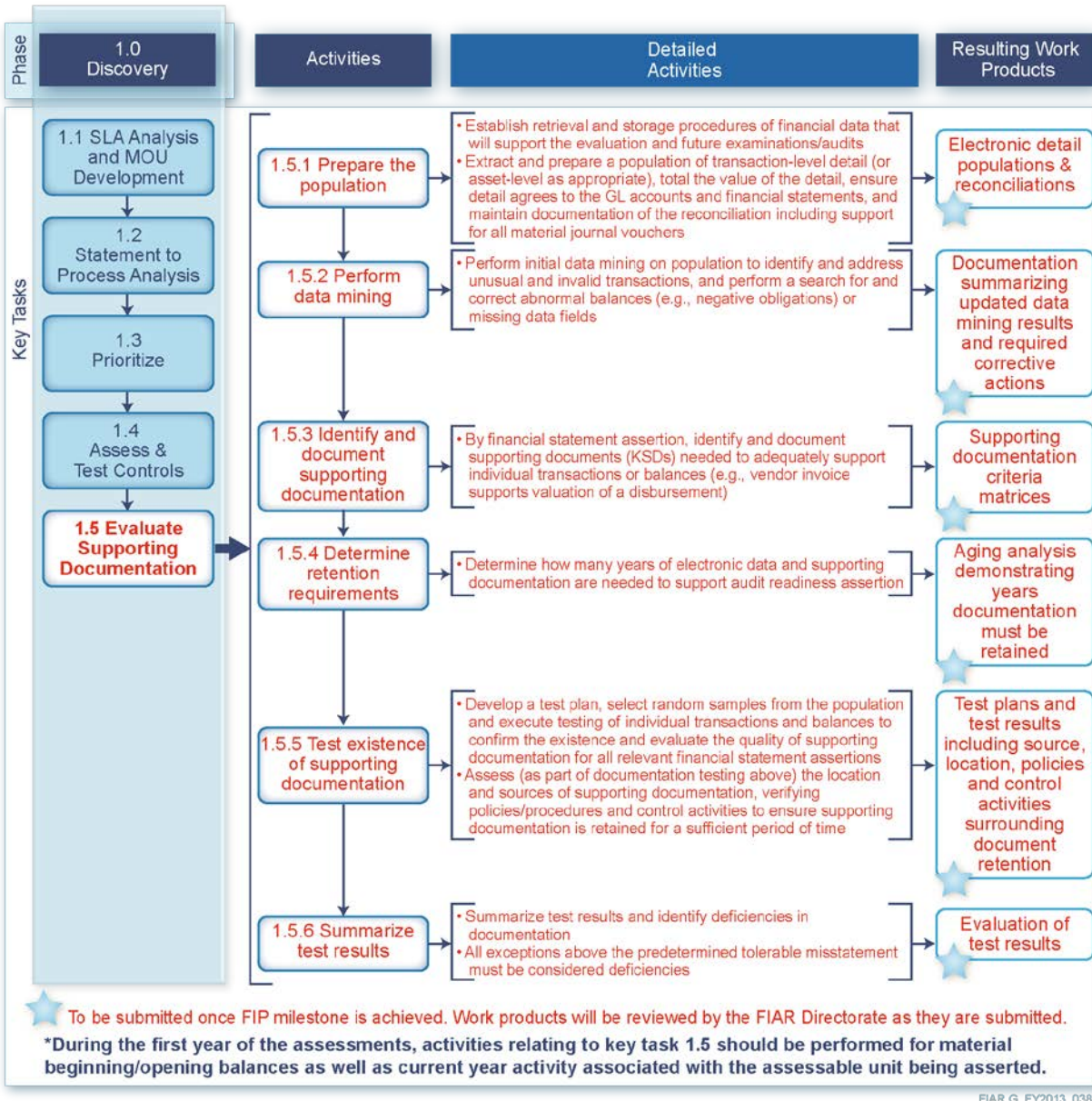


Figure 38. Discovery Phase – Evaluate Supporting Documentation

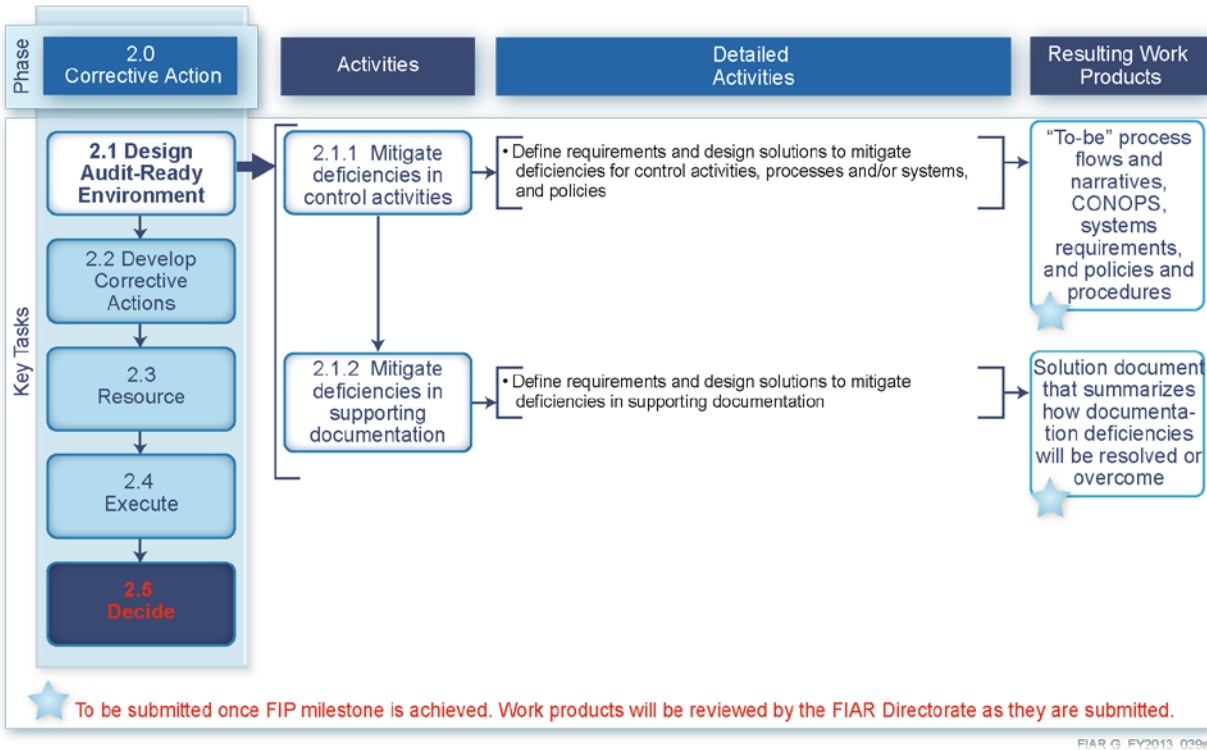


Figure 39. Corrective Action – Design Audit Ready Environment

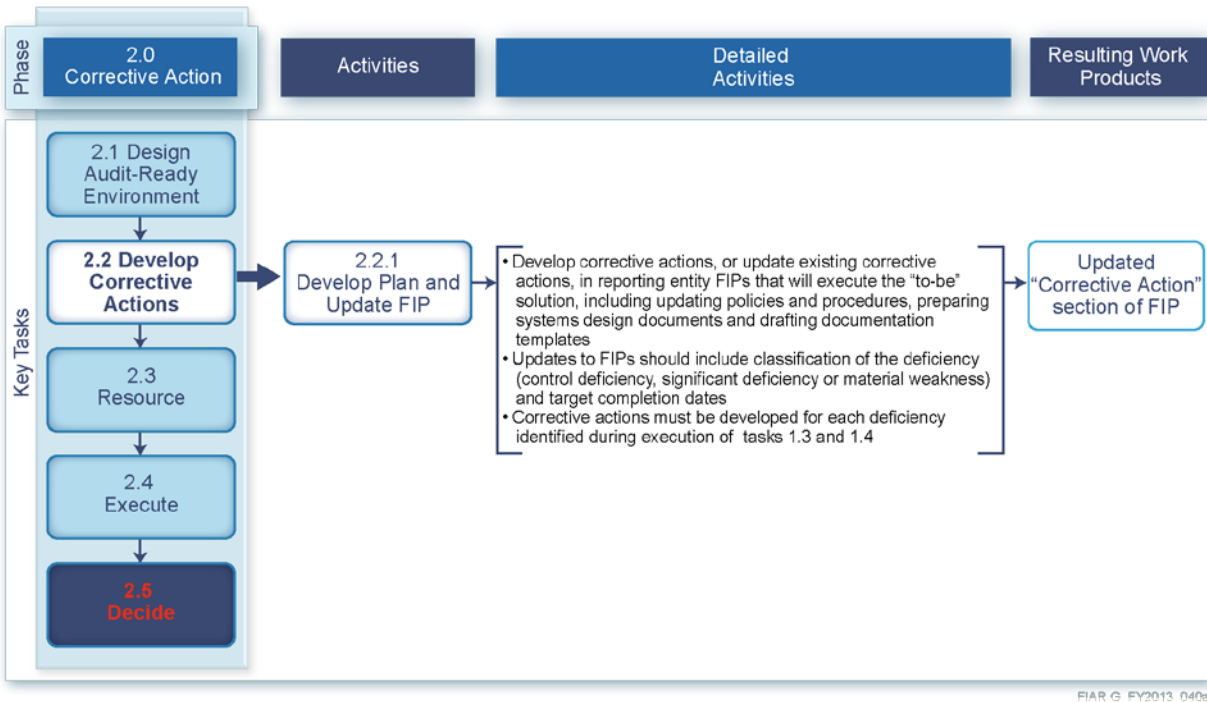
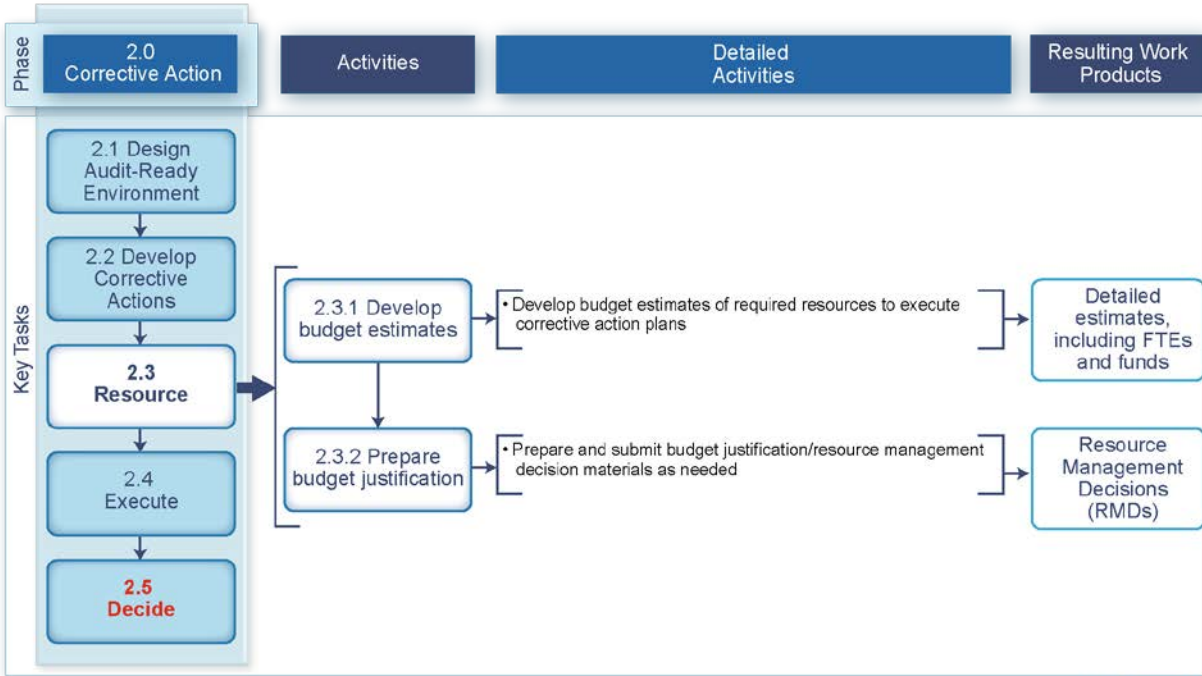
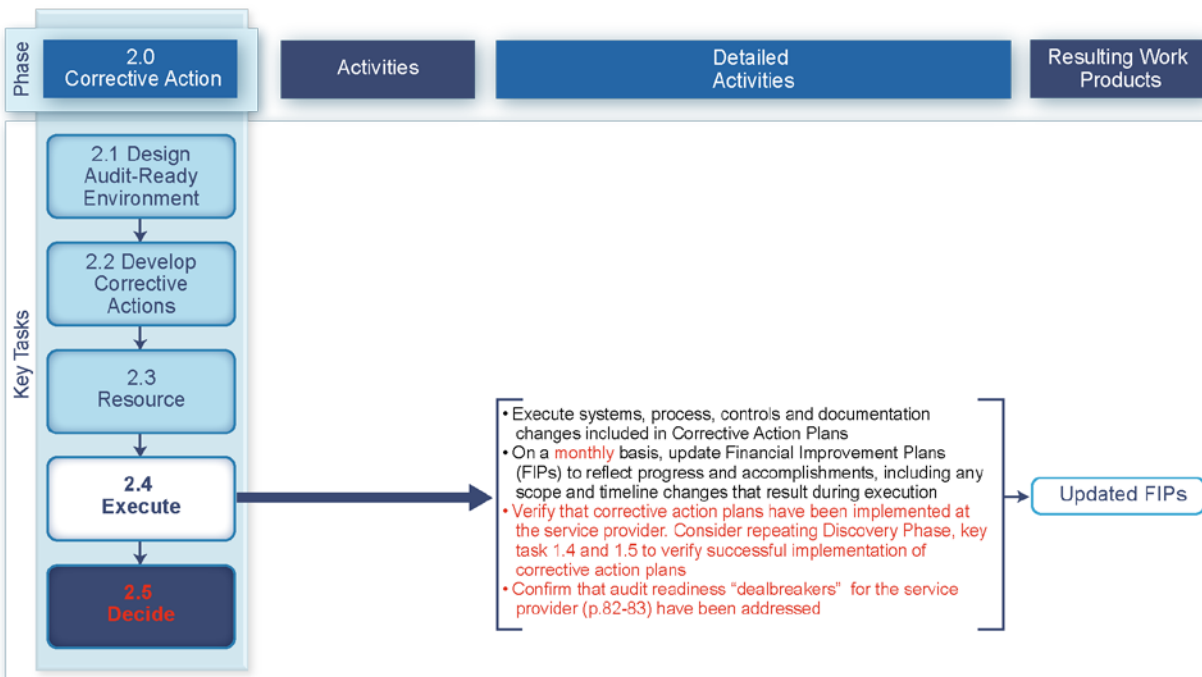


Figure 40. Corrective Action – Develop Plan and Update FIP



FIAR G_FY2013_041a

Figure 41. Corrective Action – Resource



FIAR G_FY2013_042a

Figure 42. Corrective Action – Execute

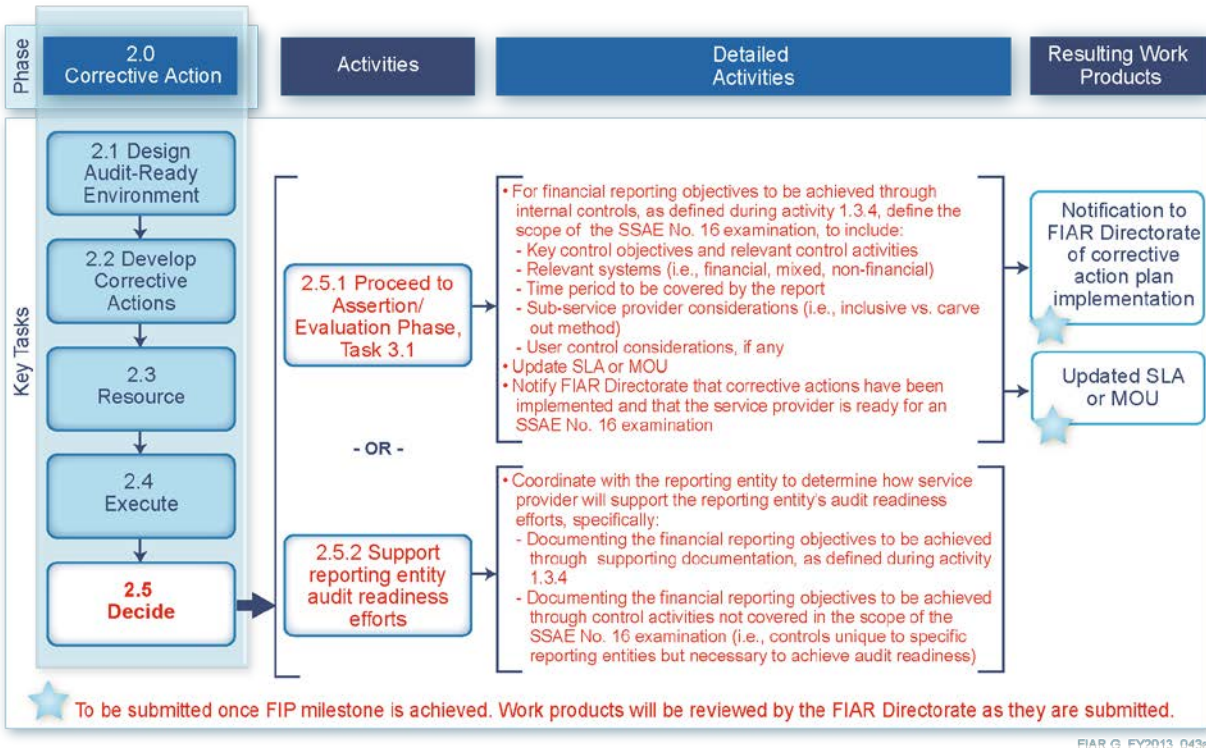


Figure 43. Corrective Action – Decide

When defining the control objectives for the SSAE No. 16 examination, the service provider should use existing guidance and best practices. For business process controls, the AICPA SSAE No. 16 Implementation Guidance outlines high level control objectives and includes illustrative examples of control objectives to be used for various service provider processes, for example, payroll processing. For the IT General and Application Controls, use the FISCAM to define control objectives. Refer to the FIAR Guidance website for those FISCAM control activities and techniques that are highly relevant for addressing key risk areas for financial reporting and other [FISCAM control activities and techniques](#) that should be considered by reporting entities and their service providers in their audit readiness efforts.

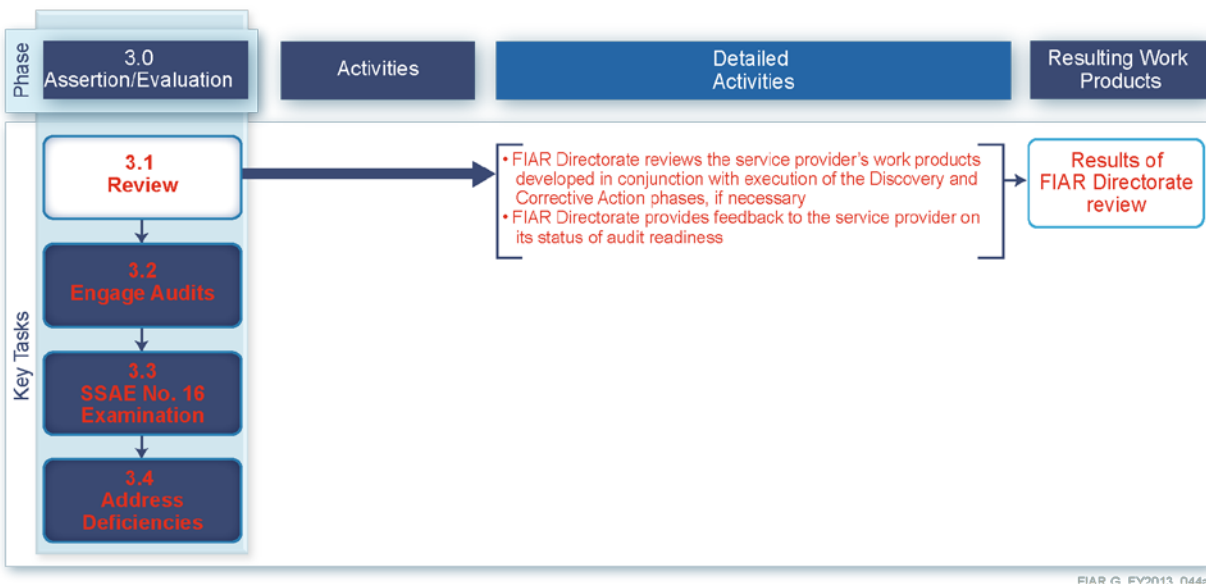


Figure 44. Assertion/Evaluation – Review and Concurrence

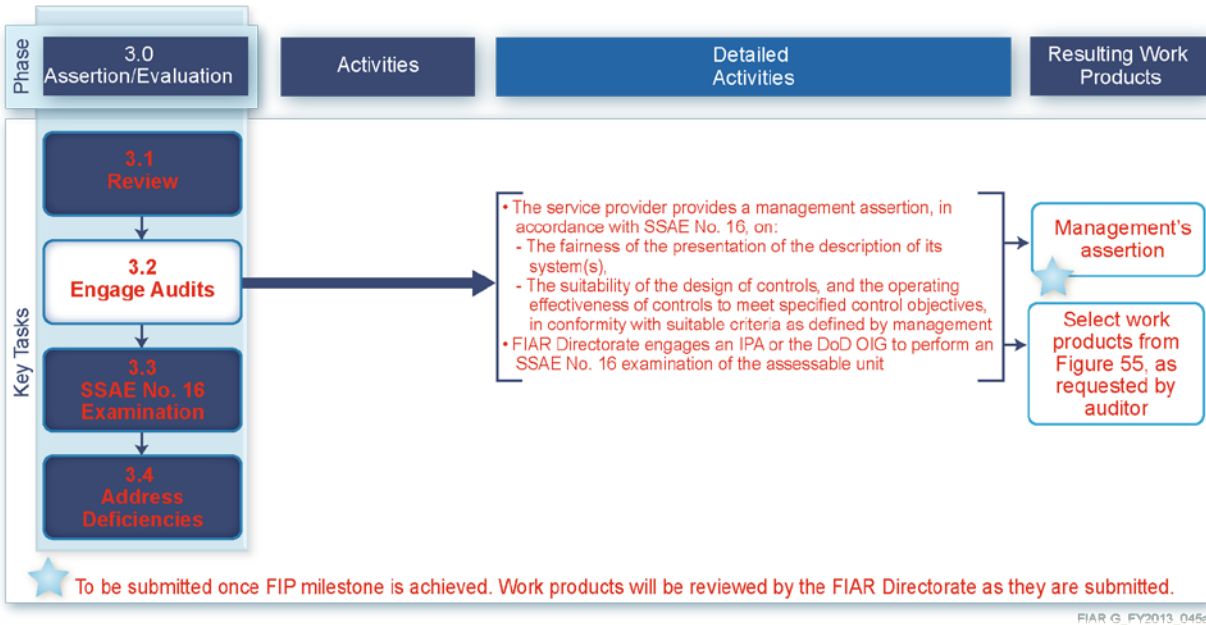


Figure 45. Assertion/Evaluation – Engage Auditor

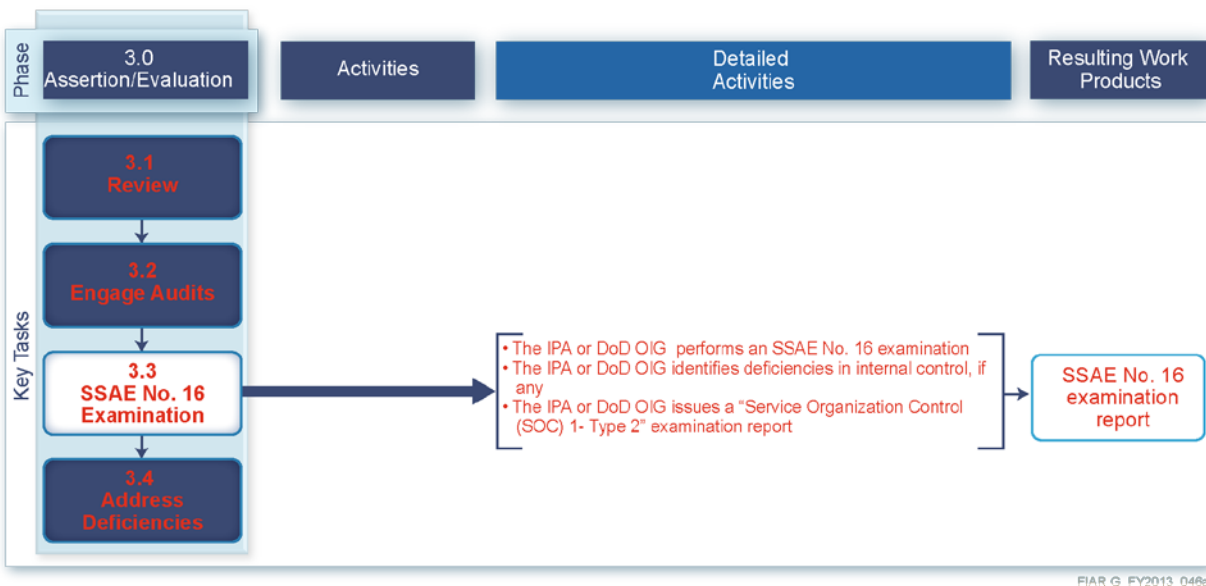


Figure 46. Assertion/Evaluation – SSAE No. 16 Examination

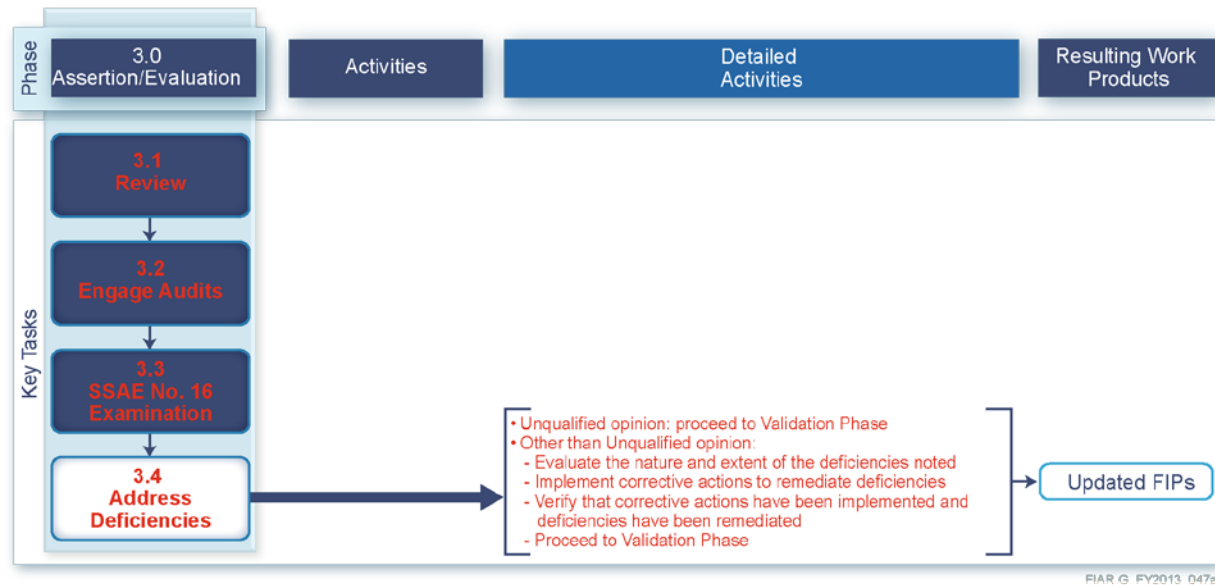


Figure 47. Assertion/Evaluation – Proceed to Validation Phase

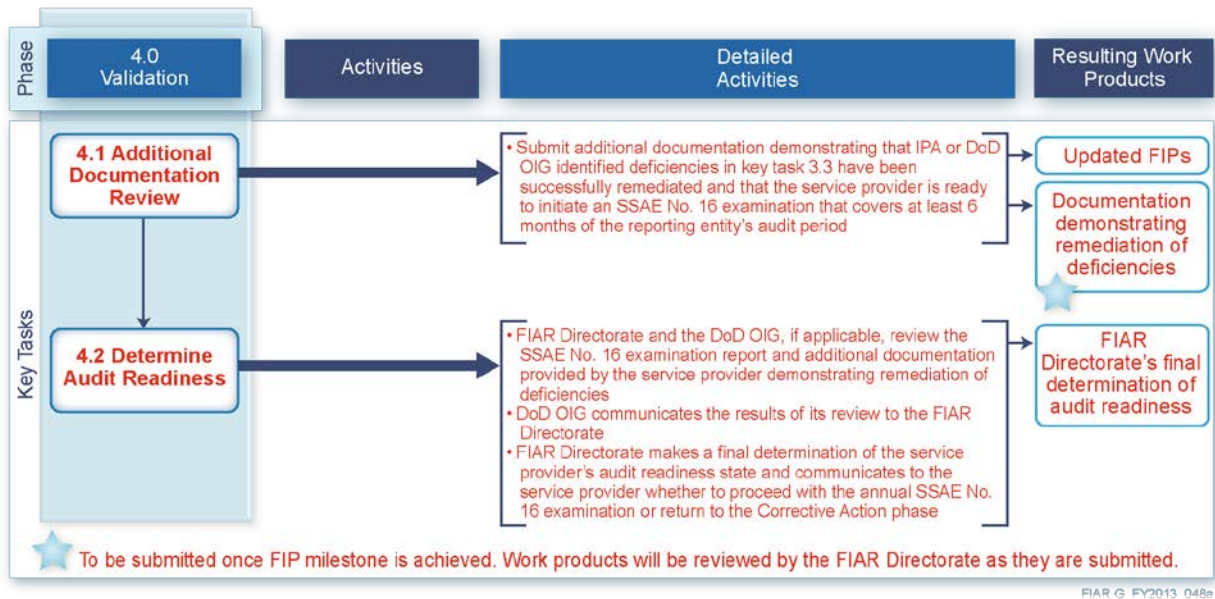


Figure 48. Validation Phase

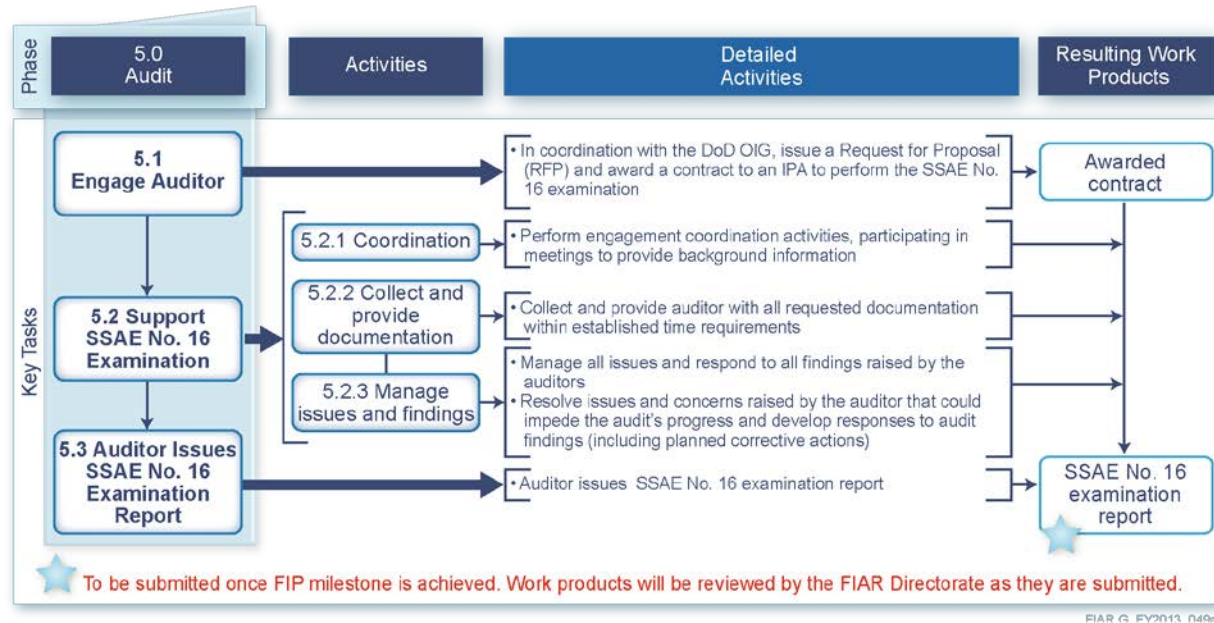


Figure 49. SSAA No. 16 Examination

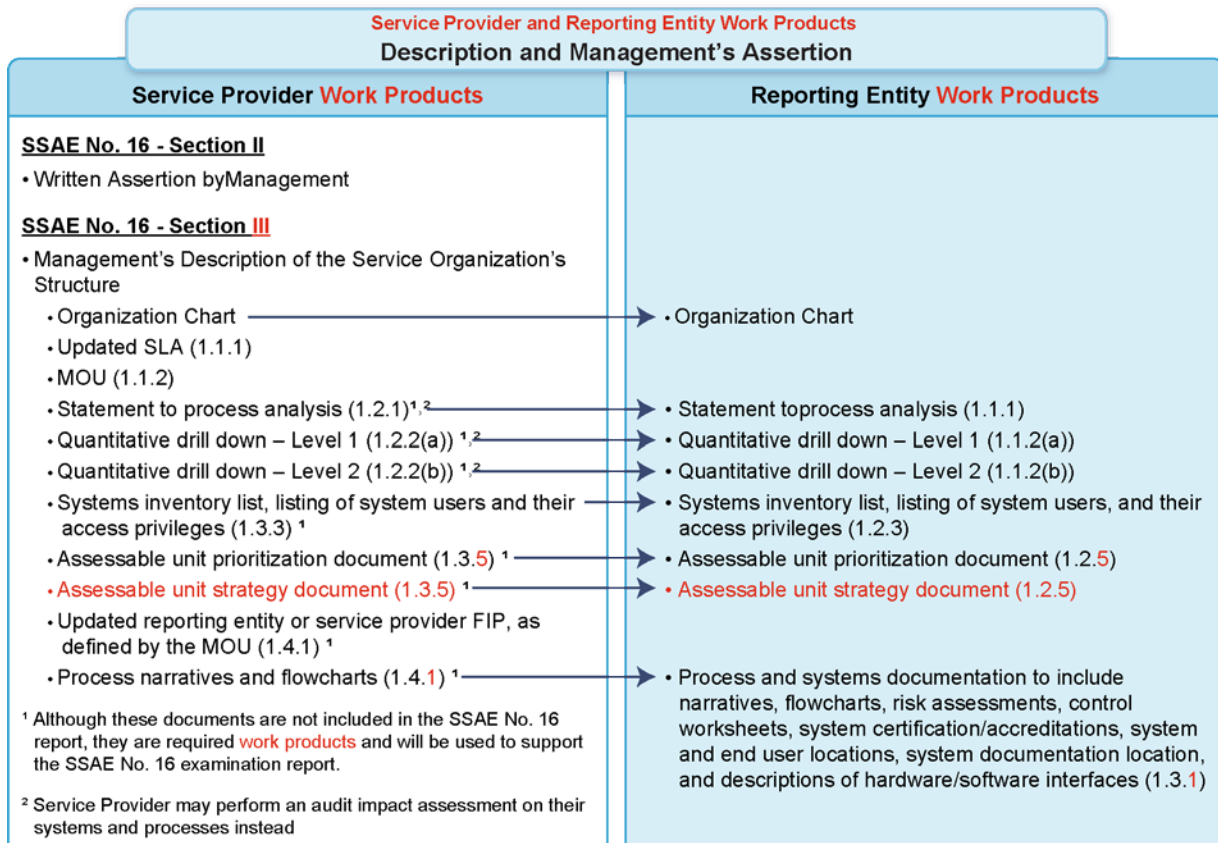
3.B.6 Work Products

Service provider **work products** must follow the format of an SSAA No. 16 report and include the information that will be included in Section III and Section IV of the Service Auditor's Report.

Section I of an SSAA No. 16 report contains the Service Auditor's Report, which describes the scope of the SSAA No. 16 examination and provides the auditor's opinion. It is not required for the service provider's assertion documentation. Section II of an SSAA No. 16 report includes management's assertion, and Section III of an SSAA No. 16 report includes a description of the service organization's "system". Section IV of an SSAA No. 16 report includes a description of the control activities in place to achieve the control objectives, as well as the test plans and the test results. Refer to the FIAR Guidance website for an example of a completed [Section IV of the SSAA No. 16](#) report and to download the [SSAA No. 16 Section IV template](#).

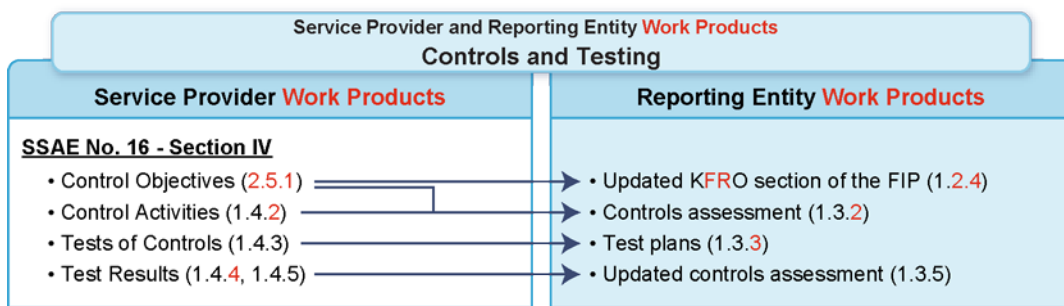
During the service provider's Discovery phase, the service provider may perform an audit impact assessment on service provider systems and processes in place of the statement to process analysis and quantitative drill downs to define the scope of the service auditor's report. **The service provider must coordinate with the reporting entity to prepare the overall statement to process analysis, quantitative drill down level 1 and quantitative drill down level 2.** The service provider will use these **work products** to determine the material processes, sub processes, and systems that the service provider is responsible for and that should be included in the scope of the SSAA No. 16 report.

The graphic below illustrates the service provider **work products** outlined in accordance with the SSAA No. 16 report for Section II and Section III, and depicts how these service provider **work products** align to supporting reporting entity **work products**. The service provider's **work products** will be incorporated into the reporting entity's **work products**.



FIAR G_FY2013_050a

Figure 50. Service Provider and Reporting Entity Work Products – SSAE No. 16 Section III



FIAR G_FY2013_051a

Figure 51. Service Provider and Reporting Entity Work Products – SSAE No. 16 Section IV

If the service provider is not prepared to assert audit readiness and undergo an SSAE No. 16 examination, the service provider is still required to provide its customers with the required work products for the reporting entity's assertion documentation. **If an SSAE No. 16 report is not available from the service provider, the service provider must be able to provide all of the required work products listed in the preceding figures to the reporting entity.**

3.B.7 Scoping the SSAE No. 16

To rely on an SSAE No. 16 examination report, the user auditor will consider many factors, including the period of time covered by the report, control objectives and control activities addressed in the report, and the results of the tests of controls and the conclusions of the service auditor. User auditor needs of the SSAE No. 16 report should be taken into consideration, whenever possible. For this reason, when information technology general or application controls are included in the scope of the SSAE No. 16 examination, the service provider should align its control objectives with GAO's Federal Information

Systems Controls Audit Manual (FISCAM). A recommended list of standardized control objectives, which are aligned to the FISCAM, is presented in the following tables.

IT General Control Objectives (CO)	
Security Management	Controls provide reasonable assurance that management has established, implemented, and monitors <application> security management programs.
Access Controls	Controls provide reasonable assurance that logical access to <application>, as well as logical and physical access to <application> (programs and data) is reasonable and restricted to authorized individuals.
Configuration Management	Controls provide reasonable assurance that changes to <application>, application programs and database structures are authorized, tested, implemented and documented.
Segregation of Duties	Controls provide reasonable assurance that management has identified, periodically reviewed, and mitigated risks of incompatible duties across <business operations and IT operations>.
Contingency Planning	Controls provide reasonable assurance that contingency planning, back-up and recovery procedures exist for <application> and are tested on a periodic basis.
Business Process Control Objectives (CO)	
Setup	Controls provide reasonable assurance that <assessable unit transaction / master data> are authorized, set up, and updated completely, accurately, and timely.
Input	Controls provide reasonable assurance that <assessable unit transactions> are received from authorized sources and are input into the application completely, accurately and timely.
Processing	Controls provide reasonable assurance that <assessable unit transactions> are processed completely, accurately, and timely; deviations from the schedule are identified and resolved timely.
Output	Controls provide reasonable assurance that <assessable unit outputs> are authorized and transmitted completely and accurately, and are processed timely.

Figure 52. IT General and Business Process Control Objectives

Service Providers without an SSAE No. 16 Examination Report

When the reporting entity is subject to a financial statement audit and the service provider does not receive an SSAE No. 16 examination report, the service provider's processes and internal controls that affect the reporting entity's financial transactions are audited as part of the reporting entity's financial statement audit. **As a result, the service provider will need to complete the key tasks and activities of the FIAR Methodology and coordinate with the reporting entities to develop the required FIAR work products (i.e., risk assessments, controls assessments, process narratives, test plans, etc.) to become audit ready.**

Service providers will be required to support the reporting entity's financial statement audit, as required by OMB Bulletin No. 07-04, as follows:

- The service provider will need to support the user auditor's evaluation of the design and operating effectiveness of internal controls at the service provider. When performing these tests, the user auditor is required to either physically observe the control activity while it is being performed or inspect documentation supporting the operating effectiveness of the control activity. Therefore, the service provider (in addition to the reporting entity) will need to make personnel who perform the control activities, as well as related supporting documentation, available for the user auditors.
- In addition to performing tests of internal controls, user auditors are required to obtain evidence supporting the accuracy of financial transactions and balances by reviewing supporting documentation that substantiates amounts reported by the reporting entity. To obtain the necessary evidence, the user auditor will typically use a combination of substantive analytical procedures (e.g., trend analysis of a balance over time) and tests of details (e.g., selecting samples of individual financial transactions and reviewing relevant supporting documentation). **To support this testing, both the reporting entity and the service provider must provide transaction-level downloads of**

reporting entity transactions accompanied by reconciliations of the transaction level detail to the general ledger and financial statements, supporting documentation for requested sample items, and personnel/responses to questions asked about trends, variances and specific financial transactions. To satisfy the user auditor requests, the reporting entity and the service provider will need to ensure that they each have an infrastructure of processes and resources established and available to quickly and effectively respond to these requests.

Reporting Entity User Control Considerations

Typical control activities that the reporting entity is responsible for implementing to complement the controls of the service provider include:

- Control activities that provide reasonable assurance that any changes to processing options (parameters) requested by the reporting entity are appropriately authorized and approved.
- Control activities that provide reasonable assurance that output received from the service provider is routinely reconciled to relevant reporting entity control totals.
- Control activities that provide reasonable assurance over passwords needed to access the systems resident at the service provider through computer terminals.

SSAE No. 16 Audit Readiness Dealbreakers

Service providers working towards an SSAE No. 16 examination are responsible for addressing the dealbreakers listed in **Figure 53** below. These separate dealbreakers are necessary because, unlike financial statement audits which are focused on determining whether the financial statements are fairly presented in accordance with GAAP, the purpose of an SSAE No. 16 examination is to express an opinion on the effectiveness of internal controls in meeting specific control objectives relevant to financial reporting. Therefore, service providers preparing for an SSAE No. 16 examination need to address these dealbreakers. During the Assertion/Evaluation phase, the FIAR Directorate will provide feedback to the service provider on the dealbreakers and recommend additional procedures to make improvements prior to an examination.

SSAE No. 16 Audit Readiness Dealbreakers	FIAR Guidance Reference
1. All material business processes and information systems (including micro-applications) are not defined or included in the scope of the SSAE No. 16 examination.	3.A.2 Consideration of Service Providers, 3.A.4 Financial Systems Considerations
2. All relevant business process and information technology control objectives that address information technology general control and transaction setup/input/processing/output risks are not included in the scope of the SSAE No. 16 examination.	3.A.2 Consideration of Service Providers, 3.B.4 Service Provider Methodology
3. All relevant service provider performed controls, user control considerations, and sub-service provider roles and responsibilities that address in scope control objectives have not been identified and included in scope for testing.	3.A.2 Consideration of Service Providers, 3.B.4 Service Provider Methodology
4. Testing conducted to assess the design and operating effectiveness of business process and information technology controls is not extensive enough to conclude as to whether the related control objectives have been satisfied.	3.A.2 Consideration of Service Providers, 3.B.4 Service Provider Methodology
5. For areas where control deficiencies have been identified during testing, the service provider has not provided sufficient documentation indicating that corrective actions have been implemented.	3.A.2 Consideration of Service Providers, 3.B.4 Service Provider Methodology

Figure 53. SSAE No. 16 Audit Readiness Dealbreakers

3.C PREPARING FOR AN AUDIT

3.C.1 Assertion Documentation

Assertion documentation consists of required work products that are prepared by reporting entities as they execute the key tasks and activities of the FIAR Methodology. Reporting entities and service providers must complete assertion documentation for each assessable unit being asserted as audit ready. However, within Wave 3 – Mission Critical Asset E&C Audit, reporting entities may prepare assertion documentation by assessable unit or sub-assessable unit indicating that the particular assessable unit or sub-unit is ready for evaluation.

The Methodology provides guidance for preparing the required work products to demonstrate successful completion of each of the five phases of the FIAR Methodology. The compilation of work products from the *Discovery and Corrective Action Phases* not only satisfies most OMB Circular A-123, Appendix A requirements, but also provides the evidence needed to demonstrate that the reporting entity is ready for audit.

The goal of the FIAR Methodology, and therefore, the assertion documentation is to provide evidence demonstrating that the reporting entity has:

- Identified and evaluated the risk of material misstatement
- Identified the financial reporting objectives (FROs) relevant to the subject matter, assertion or processes that must be audit ready
- Designed and implemented an appropriate combination of control activities and supporting documentation, defined as KSDs, to mitigate the risk of material misstatement and achieve the FROs and
- Ensured that the supporting documentation identified above is sufficient, relevant and accurate to support financial transactions, account balances, and financial statement line items.

Reporting entity management must decide how it will achieve audit readiness. The reporting entity must rely on effective control activities, but has flexibility with regard to how much to rely on internal controls, as shown in Figure 54. In general, areas with large transaction volumes or numerous individual assets (e.g., supply, contracts, FBWT, Inventory, OM&S, GE, etc.) require management and the auditor to rely on effective control activities to provide assurance that balances are properly stated at any given date. Management's determination that effective internal controls are not in place to mitigate risk does not necessarily preclude an assertion of audit readiness. For example, management may decide that it is more efficient to rely on supporting documentation and limit internal controls reliance for the existence and completeness assertion of low volume items, such as satellites. However, for populations with a large number of items or with a high volume of transaction activity, such as OM&S, it is more effective and efficient to place more reliance on internal controls, which requires detailed internal control documentation, including risk and internal controls assessments. In cases where management reduces internal controls reliance, the reporting entity must provide extensive supporting evidence in the assertion documentation to offset the low reliance on internal controls.

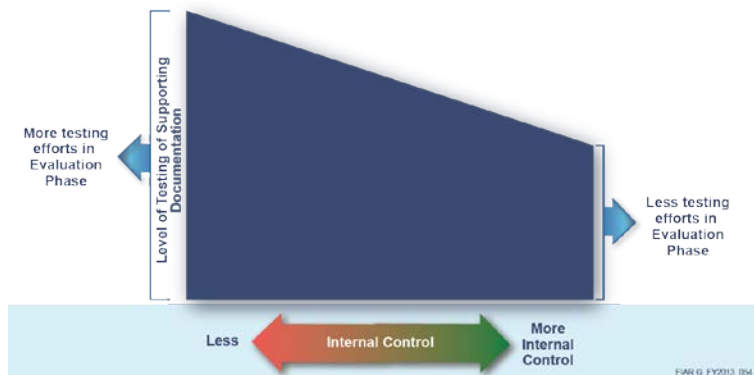


Figure 54. Reliance on internal controls affects the level of testing of supporting documentation

ITGCs and application controls must be designed effectively and tested for operating effectiveness in order for management to rely on the automated controls and system generated reports (i.e., KSDs). Supporting documentation testing (i.e., substantive testing) cannot overcome ineffective or missing ITGCs and application controls when transaction evidence is electronic and only maintained within a system, or the key supporting evidence is system generated reports.

3.C.2 Assertion Documentation Interim Reviews

As Reporting entities complete the key tasks and activities required by the FIAR Methodology, they are required to prepare and submit “audit ready” assertion documentation (i.e., process narratives, flow charts, test plans, etc.) supporting their audit readiness assertions to the FIAR Directorate for review. Figure 55 contains a graphical depiction of the required work products that must be submitted as assertion documentation.

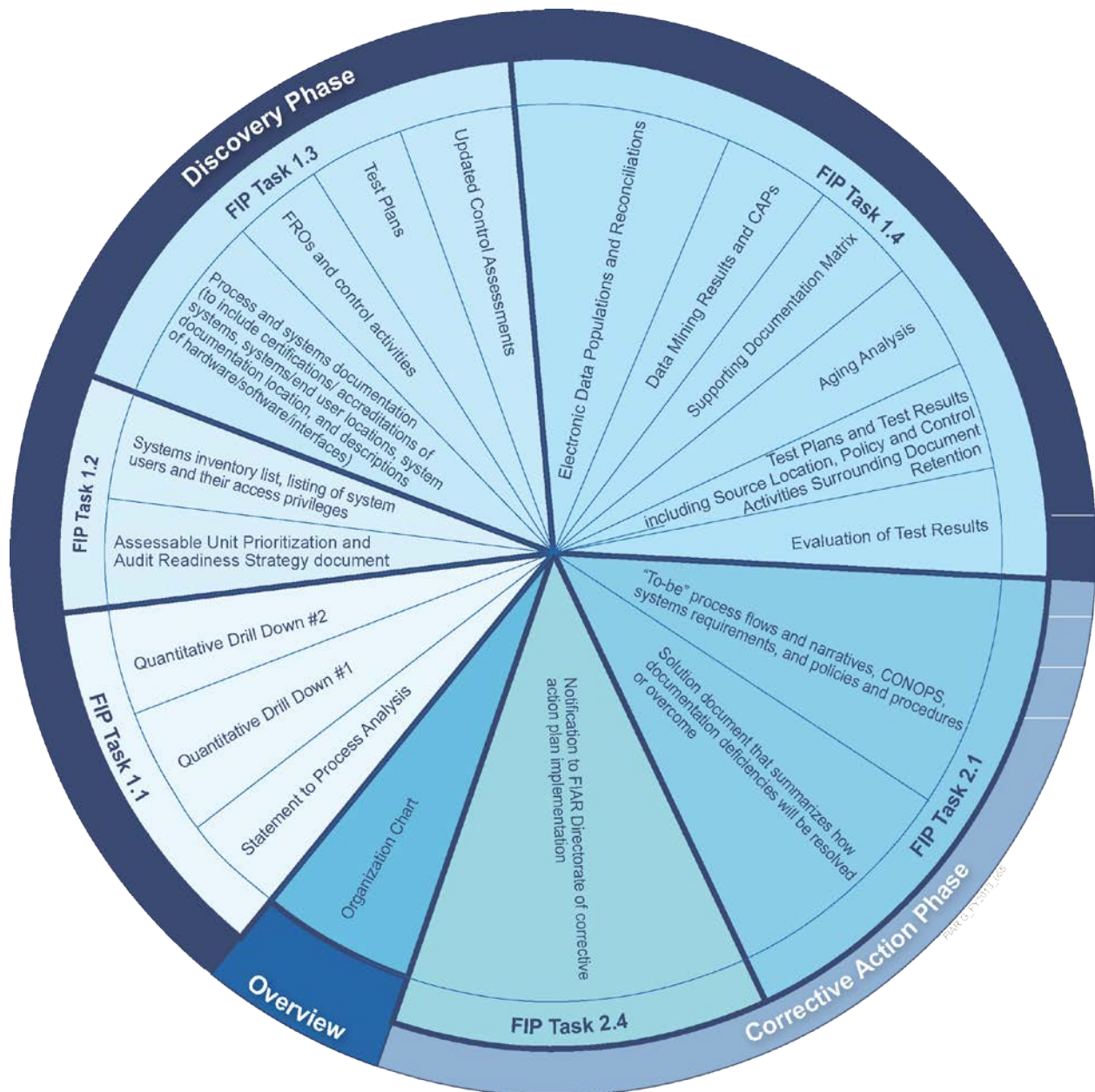


Figure 55. Assertion Documentation Work Products Requirements

Assertion documentation must be provided in electronic format, through the FIAR Planning Tool, so that the documentation is readily accessible for the FIAR Directorate, DoD OIG or other independent auditor reviews. The FIAR Directorate will review the work products as they are submitted by the reporting entities, and provide the reporting entities with detailed feedback and recommendations on additional work needed. The FIAR Directorate reviews assertion documentation to determine whether the reporting entity and/or the service provider are audit ready and provides recommendations for additional procedures, to make improvements, prior to an examination.

3.C.3 Management Assertion Process for IPA or DoD OIG Examinations

Once the FIAR Directorate completes its review of the reporting entity's assertion documentation, the reporting entity will prepare and submit a management assertion letter to the IPA or the DoD OIG declaring that the subject matter (assessable unit) is audit ready. Refer to Section 2.D. for guidance on preparing management assertions.

The assertion must be signed by the person, individual, or representative of the organization responsible for the subject matter (assessable unit). Depending on the assessable unit being asserted as audit ready, either an IPA or the DoD OIG will perform an examination of management's audit readiness assertion.

3.C.4 Management Assertion Process for FIAR Assertion/Evaluation (Phase 3.0)

Once the IPA or DoD OIG completes its examination report, the reporting entity can proceed to the Validation phase, if the examination report is unqualified. If the examination report is not an unqualified report, the reporting entity must: 1) evaluate the nature and extent of deficiencies noted by the auditor, 2) implement corrective actions to remediate the deficiencies noted, and 3) perform procedures to verify that corrective actions have been implemented and successfully remediate the deficiencies. Once these tasks have been completed, the reporting entity is ready to proceed to the **Validation** phase (4.0).

During the **Validation** Phase (4.0), reporting entities additional documentation demonstrating that IPA or DoD OIG identified deficiencies have been successfully remediated.

3.C.5 Human Capital

The reporting entity must ensure that the personnel assigned to perform FIAR activities have the necessary competence. This includes having a basic knowledge of accounting and auditing concepts, including:

- familiarity with financial statements and their content,
- understanding of financial statement assertions,
- knowledge of accounting requirements, including DoD policies,
- understanding of internal controls, and
- familiarity with the reporting entity's systems.

After determining the assessable units, the reporting entity should identify the competencies required (e.g., accounting, information technology, fiscal law) to achieve auditability and reliable financial information and determine whether the personnel assigned to audit readiness tasks have the required competencies or whether those competencies need to be developed.

The Office of the Under Secretary of Defense (Comptroller) has developed [FM myLearn](#), a multi-purpose website for DoD financial management workforce, to serve as an online catalog of professional training opportunities for financial management personnel and support career-long learning objectives. The people assigned to FIAR activities should participate in financial management training, ensuring that they have sufficient knowledge of accounting and auditing requirements to complete the tasks accurately.

In addition to competence, the people who perform the work must have the necessary objectivity. Persons responsible for evaluating the design of internal controls, performing tests of operating

effectiveness, validating the sufficiency of corrective actions and testing for the adequacy of supporting documentation should not be the personnel responsible for performing the control or reporting directly to the person performing the control. Preferably, personnel performing discovery audit readiness efforts are outside of the organization unit that is responsible for carrying out the day-to-day operational activities.

3.C.6 Necessary Infrastructure

Reporting entities undergoing a first-year audit frequently underestimate the workload and level of effort needed to support their auditors. With a need to substantiate beginning balances, first-year audits require substantially larger sample sizes and place greater demands on both the auditor and auditee. To manage this surge in effort, reporting entities should have the infrastructure in place before beginning a first-year audit. The entity should establish a project management office (PMO) to create and sustain this infrastructure during the first-year audit. The PMO should focus on the following major tasks:

Audit Coordination

During a first-year audit, auditors typically spend a significant amount of time gaining an understanding of the entity under audit. This is accomplished through reviews of documentation (i.e., policies and procedures, agency financial reports) and interviews with key personnel. The coordination and satisfaction of these auditor requests for documentation and interviews is essential to providing auditors with the information they need, within their time constraints, to help support a successful and timely audit.

Document Management

All first-year audits include requests for substantial supporting documentation to verify management's beginning balances. In a first-year audit, sample sizes can be three times the size of those for a recurring audit; therefore, management should establish an infrastructure to manage these requests, as well future audits. This infrastructure includes receiving requests from the auditors, coordinating with field personnel to collect and submit the documentation to the auditors, and responding to auditor questions about the documentation. In a first-year audit, it is common for management to receive a large number of auditor questions about supporting documentation because the auditors are building an understanding of the entity and its operations.

Issue/Finding Management

As the audit progresses, the following two kinds of issues typically arise, especially during first-year audits:

- **Audit Impediments** – Typical impediments include unorganized documentation and issues surrounding the format and content of system downloads. As such, conflicts will occur due to competing demands on limited resources. These impediments must be identified, discussed, and promptly resolved. Otherwise, the likelihood of delays in schedule (and potential scope restrictions) increases due to the cumulative effect of these issues.
- **Audit Findings** – As the audit progresses, the auditors will identify findings and recommendations. **The reporting entity must develop Plans of Action and Milestones (POAMs) and assign resources to lead remediation for findings the reporting entity agrees are valid.** Without periodic PMO monitoring, there is a risk that remediation efforts will not be sustained. Significant control deficiencies contribute directly to additional time and auditor fees because alternative procedures must be performed to overcome control deficiencies. Therefore, timely and effective remediation of audit findings results in direct savings of Departmental resources.

3.D AUDIT EXECUTION

3.D.1 Examination Process

Reporting Entities

Once the reporting entities confirm that the work products address the audit readiness dealbreakers and are sufficient and accurate to support their audit readiness assertion, the FIAR Directorate will engage an independent auditor or the DoD OIG to perform an examination of the reporting entity's assertion. During the *Assertion/Evaluation Phase*, a reporting entity will undergo an examination of an assessable unit.

If the examination results in an unqualified opinion, reporting entities (Category 1) can proceed to the *Validation Phase*. Should the examination indicate that an assessable unit is not audit ready, as defined by a qualified opinion or disclaimer of opinion, the reporting entity must evaluate the nature and extent of the deficiencies noted and implement corrective actions to remediate the deficiencies. Reporting entities must also perform procedures to verify that the corrective actions successfully remediated the deficiencies. During the *Validation Phase*, the reporting entity will submit additional documentation, to the FIAR Directorate, demonstrating that auditor identified deficiencies have been successfully remediated. The FIAR Directorate will review the additional documentation submitted and determine the assessable unit's audit readiness state. Upon a favorable determination of audit readiness from the FIAR Directorate, the reporting entity will proceed to the *Audit Phase*.

The specific scope of the audits will vary depending upon the wave the audit readiness assertion relates to. For example, note from **Figure 56**, that reporting entities asserting audit readiness for Wave 3 will undergo an audit and receive a specified elements audit opinion, which is issued in connection with audits of specified elements, accounts or items of a financial statement. Similarly, once a reporting entity asserts audit readiness for Wave 2, it will undergo an audit of Schedules of current year appropriations and associated activity only. Once the reporting entity receives an unqualified opinion on its schedules of budgetary activity, reporting entities will commence a full scope financial statement audit of the SBR. A reporting entity asserting audit readiness at the completion of Wave 4 will undergo a financial statement audit of the complete set of financial statements (e.g., Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, etc.). Once an assessable unit or full financial statement is in sustainment, audits will be performed annually. Further details on individual waves are discussed in the specific wave section.

Other Defense Organizations (ODOs)

As individual other defense organizations (ODOs) assert audit readiness for their material assessable units, the FIAR Directorate will review the assertion documentation submitted by each ODO reporting entity to determine if the entity is ready to undergo an assertion examination, either individually or collectively, by an Independent Public Auditor (IPA).

	Assertion/Evaluation Phase	Audit Phase
WAVE 1		
• Appropriations Received Assessable Unit	Assertion Examination by IPA or DoD OIG	Not applicable until full SBR is audit ready
WAVE 2		
• SBR Assessable Units	Assertion Examination by IPA or DoD OIG	Not applicable until full SBR is audit ready
• Current Year SBR Activity • Full SBR	Assertion Examination by IPA or DoD OIG	Audit by IPA or DoD OIG
WAVE 3		
• Mission Critical Asset Assessable Units	Assertion Examination by DoD OIG	Specified Elements Audit by IPA or DoD OIG
WAVE 4		
• All Financial Statements	Assertion Examination by IPA or DoD OIG	Audit by IPA or DoD OIG

FIAR G_FY2013_056

Figure 56. Assertion/Evaluation and Audit Phases for each Wave

APPENDIX A – MATERIAL REPORTING ENTITIES

The Department of Defense (Department or DoD), with its many reporting entities preparing stand-alone financial statements, has a complex reporting structure. Its reporting entities vary significantly from a financial statement perspective (e.g., the Military Departments are few in number but material to the Department, versus the other Defense Agencies, which are large in number but less material than the Military Departments). Therefore, it is not effective or efficient to perform financial statement audits on all stand-alone financial statements. To increase the efficiency of the annual financial statement audits, reporting entities have been grouped into one of three categories as follows:

- **Category 1** – includes the Military Departments, Military Retirement Fund, and the U.S. Army Corps of Engineers Civil Works Program (in accordance with the requirements of OMB Bulletin No. 07 – 04, as amended). These reporting entities must perform all audit readiness efforts in accordance with the Financial Improvement and Audit Readiness (FIAR) Methodology and will undergo annual financial statement audits on their stand-alone financial statements.
- **Category 2** – includes other material reporting entities not included in Category 1. These reporting entities must perform all audit readiness efforts in accordance with the FIAR Methodology, but are not required to undergo annual stand-alone financial statement audits. Instead, these reporting entities will be audited as part of the Department's consolidated financial statement audit. **Figure 1** on the following page presents all financially material reporting entities, and identifies specific areas of the reporting entity that are material to the Department's consolidated financial statements.
- **Category 3** – includes all immaterial reporting entities not presented in **Figure 1** or the remainder of the Department. While these immaterial reporting entities need to become audit ready and will be part of the Department's consolidated financial statement audit, they do not need to report their progress to the FIAR Directorate and are not required to undergo stand-alone financial statement audits. Office of the Under Secretary of Defense (Comptroller) (OUSD(C)) will regularly update this analysis to confirm that all reporting entities material to the Department are appropriately identified and focused on performing audit readiness activities. OUSD(C) will communicate the updated analyses separate from this guidance.

Reporting Entities	Audit Readiness Category	Waves 1 & 2	Waves 3 & 4				
		SBR	ME	RP	INV	OM&S	GE
Under Audit							
Military Retirement Trust Fund	Category 1	✓					
U.S. Army Corps of Engineers – Civil Works	Category 1	✓		✓	✓	✓	✓
United States Marine Corps, GF	Category 1 (part of Navy GF)	✓	●	●	●	●	●
Tricare Management Activity (CRM)	Category 2	✓					
Medicare-Eligible Retiree Healthcare Fund	Category 2	✓					
Defense Commissary Agency	Category 2	✓		✓	✓		✓
Defense Finance and Accounting Service	Category 2	✓		✓			✓
Defense Contract Audit Agency	Category 2	✓					✓
Office of the Inspector General, DoD	Category 2	✓					
Preparing for Audit							
Army, GF	Category 1	✓	✓	✓		✓	✓
Air Force, GF	Category 1	✓	✓	✓		✓	✓
Navy, GF	Category 1	✓	✓	✓		✓	✓
Military Retirement Fund Payment*	Category 2	✓					
Defense Logistics Agency, WCF	Category 2	✓		✓		✓	✓
Navy, WCF	Category 1	✓		✓	✓	✓	✓
DoD Component Level Accounts	Category 2	✓					
Service Medical Activity	Category 2	✓					
Army, WCF	Category 1	✓		✓	✓		✓
Office of the Secretary of Defense (WHS)	Category 2	✓		✓			
Pentagon Reservation Maintenance Revolving Fund	Category 2			✓			
UNAL/DIS-DoD Component Level Accounts (USD(C))	Category 2	✓		✓			✓
Washington Headquarters Services	Category 2						✓
Air Force, WCF	Category 1	✓		✓	✓	✓	✓
U.S. Special Operations Command	Category 2	✓		✓			✓
Missile Defense Agency	Category 2	✓		✓			

Reporting Entities	Audit Readiness Category	Waves 1 & 2	Waves 3 & 4				
		SBR	ME	RP	INV	OM&S	GE
U.S. Transportation Command Air Force – Air Mobility Command	Category 2	✓					
Other 97 Funds Provided to the Army by OSD	Category 2	✓					
Defense Information Systems Agency, WCF	Category 2	✓					
Defense Advanced Research Projects Agency	Category 2	✓					
DoD Education Activity	Category 2	✓					
Tricare Management Activity – Financial Operations Division (FOD)	Category 2	✓					✓
Defense Information Systems Agency, GF	Category 2	✓					✓
U.S. Transportation Command Army – Military Surface Deployment & Distribution	Category 2	✓					
Chemical Biological Defense Program	Category 2	✓					
Defense Security Cooperation Agency	Category 2	✓					
Defense Threat Reduction Agency	Category 2	✓					
Defense Contract Management Agency	Category 2	✓					
Defense Logistics Agency, GF	Category 2	✓					
Defense Technical Information Center	Category 2	✓					
United States Marine Corps, GF	Category 1		✓	✓		✓	✓
United States Marine Corps, WCF	Category 1	✓		✓	✓	✓	✓
✓ = Material to DoD Consolidated financial statements ● = USMC currently undergoing SBR audit only							
* Reporting entities planned for standalone audit (Category 1) will perform all audit readiness phases (i.e., Discovery, Corrective Action, Assertion/Evaluation, Validation and Audit. However, reporting entities in planned for DoD consolidated audit (Category 2) will stop after performing the Validation phase.							
* Reporting entities planned for DoD consolidated audit (Category 2) are allowed to procure audits if they desire to do so.							

Figure 1. Material reporting entities to DoD Consolidated Financial Statements

WAVES 1 AND 2

All reporting entities needed to achieve coverage of at least 99 percent of the Department's total Budgetary Resources are designated as material reporting entities that must complete Waves 1 and 2. The Department has concluded that all amounts greater than one percent are considered material; therefore, the Department must ensure that at least 99 percent of the amounts reported are audit ready prior to asserting Department-wide audit readiness. This materiality threshold ensures the Department is focusing its limited resources on its significant reporting entities.

The following table summarizes the analysis performed to ensure that all material reporting entities were appropriately included in Waves 1 and 2 audit readiness efforts. This analysis further identifies reporting entities that are currently undergoing audits or are preparing for an audit.

The Department depends on many reporting entities to reach coverage totaling nearly 100 percent of Budgetary Resources and achieve an auditable Department-wide SBR. By combining the 14 percent coverage already achieved with the 85 percent coverage from the Military Departments and other reporting entities, the Department will have coverage on over 99 percent of its total Budgetary Resources. The remaining entities summarized in the following table as "Immaterial Reporting Entities" are deemed immaterial to the Department based on current reported account balances. While these immaterial reporting entities should follow this guidance to become audit ready, they are not required to report their progress to the FIAR Directorate. OUSD(C) will regularly update this analysis to confirm that all reporting entities material to the Department are appropriately identified and focused on performing audit readiness activities. OUSD(C) will communicate the updated analyses separate from this guidance.

This appendix provides the Department's evaluation of materiality in determining which reporting entities are considered material for each wave of the FIAR strategy.

Note: The material reporting entities analysis performed for Waves 1 – 3 included below is based on FY 2009 financial statement reported amounts. For FY 2012, the line number for Total Budgetary Resources Balance in Statement of Budgetary Resources is 1910.

Organization	SBR Line 7, Total Budgetary Resources Balance (FY2009)	Percent of Balance	Planned Audit Type
Under Audit			
Military Retirement Fund	\$ 50,303,962,635	4.27%	Category 1
U.S. Army Corps of Engineers - Civil Works	\$ 40,394,543,982	3.43%	Category 1
United States Marine Corps, GF	\$ 38,391,004,750	3.26%	Category 1
Tricare Management Activity (CRM)	\$ 14,268,323,055	1.21%	Category 2
Medicare -Eligible Retiree Healthcare Fund	\$ 8,290,649,170	0.70%	Category 2
Defense Commissary Agency	\$ 7,655,363,185	0.65%	Category 2
Defense Finance and Accounting Service	\$ 1,600,708,030	0.14%	Category 2
Defense Contract Audit Agency	\$ 501,701,746	0.04%	Category 2
Office of the Inspector General, DoD	\$ 318,440,862	0.03%	Category 2
Subtotal Under Audit	\$ 161,724,697,415	13.73%	
Preparing for Audit			
Army, GF	\$ 320,490,685,931	27.20%	Category 1
Air Force, GF	\$ 201,591,287,902	17.11%	Category 1
Navy, GF	\$ 185,530,753,342	15.75%	Category 1
Military Retirement Fund Payment*	\$ 65,530,000,000	5.56%	Category 2
Defense Logistics Agency, WCF	\$ 38,007,067,441	3.23%	Category 2
Navy	\$ 29,024,958,565	2.46%	Category 1
DoD Component Level Accounts	\$ 27,630,141,514	2.35%	Category 2
Service Medical Activity	\$ 21,085,592,983	1.79%	Category 2
Army, WCF	\$ 18,718,420,062	1.59%	Category 1
Office of the Secretary of Defense (WHS)	\$ 17,898,445,770	1.52%	Category 2
Air Force, WCF	\$ 11,611,967,179	0.99%	Category 1
U.S. Special Operations Command	\$ 11,515,699,390	0.98%	Category 2
Missile Defense Agency	\$ 9,684,128,234	0.82%	Category 2
U.S. Transportation Command Air Force - Air Mobility Command	\$ 9,384,961,552	0.80%	Category 2
Other 97 Funds Provided to the Army by OSD	\$ 5,718,523,836	0.49%	Category 2
Defense Information Systems Agency, WCF	\$ 5,556,128,764	0.47%	Category 2
Defense Advanced Research Projects Agency	\$ 4,630,405,349	0.39%	Category 2
DoD Education Activity	\$ 3,398,056,969	0.29%	Category 2
Tricare Management Activity- Financial Operations Division (FOD)	\$ 2,618,643,987	0.22%	Category 2
Defense Information Systems Agency, GF	\$ 2,600,758,230	0.22%	Category 2
U.S. Transportation Command Army -Military Surface Deployment & Distribution	\$ 2,590,281,123	0.22%	Category 2
Chemical Biological Defense Program	\$ 2,317,164,642	0.20%	Category 2
Defense Security Cooperation Agency	\$ 1,705,910,466	0.14%	Category 2
Defense Threat Reduction Agency	\$ 1,542,102,738	0.13%	Category 2
Defense Contract Management Agency	\$ 1,284,093,209	0.11%	Category 2
Defense Logistics Agency, GF	\$ 1,124,337,523	0.10%	Category 2
Defense Technical Information Center	\$ 1,044,309,843	0.09%	Category 2
United States Marine Corps, WCF	\$ 994,114,351	0.08%	Category 1
Subtotal Preparing for Audit	\$ 1,004,828,940,895	85.29%	
Immaterial Reporting Entities	\$ 11,541,410,258	0.98%	Category 3
Total	\$ 1,178,095,048,568	100.00%	
<p>* Military Fund Retirement Payment is not a traditional reporting entity. This entity represents a Treasury account that is only used to receive and disburse appropriations to the Military Retirement Trust Fund.</p> <p>* Reporting entities in Category 1 will perform all audit readiness phases (i.e., Discovery, Corrective Action, Assertion/Evaluation, Validation and Audit. However, reporting entities in Category 2 will stop after performing the Validation phase.</p> <p>* Reporting entities in Category 2 are allowed to procure audits if they desire to do so.</p>			

Figure 2. FY 2009 Material Reporting Entities for SBR

WAVE 3

All reporting entities needed to achieve coverage of at least 99 percent of material Department asset categories are designated as material reporting entities that must complete Wave 3. The Department has concluded that all amounts greater than 1 percent are considered material; therefore, the Department must ensure that at least 99 percent of the amounts reported are audit ready prior to asserting Department-wide audit readiness. This materiality threshold ensures the Department is focusing its limited resources on its significant reporting entities.

The following tables summarize the analysis performed to ensure all material reporting entities were appropriately included in Wave 3 audit readiness efforts for the five major asset categories. This analysis further identifies reporting entities that are currently undergoing audits, or are preparing for audit.

Military Equipment

Reporting Entities	Military Equipment - Acquisition Value (FY 2009) Dollars in Thousand	Percent of Balance	Planned Audit Type
Preparing for Audit			
Navy, GF	\$ 337,303,591,871	42.33%	Category 1
Air Force, GF	\$ 300,284,137,963	37.68%	Category 1
Army, GF	\$ 141,160,619,600	17.71%	Category 1
United States Marine Corps, GF	\$ 11,202,272,000	1.41%	Category 1
Subtotal Preparing for Audit	\$ 789,950,621,434	99.14%	
Immaterial Reporting Entities	\$ 6,891,979,363	0.86%	Category 3
Total	\$ 796,842,600,797	100.00%	
<ul style="list-style-type: none"> • Reporting entities in Category 1 will perform all audit readiness phases (i.e., Discovery, Corrective Action, Assertion/Evaluation, Validation and Audit). However, reporting entities in Category 2 will stop after performing the Validation phase. • Reporting entities in Category 2 are allowed to procure audits if they desire to do so. 			

Figure 3. FY 2009 Material Reporting Entities for Military Equipment

Real Property

Organization	Real Property - Acquisition Value (FY 2009) Dollars in Thousand	Percent of Balance	Planned Audit Type
Under Audit			
US Army Corps of Engineers - Civil Works	\$ 40,658,819,493	17.45%	Category 1
Defense Commissary Agency	\$ 2,029,566,000	0.87%	Category 2
Defense Finance and Accounting Service	\$ 123,563,000	0.05%	Category 2
Subtotal Under Audit	\$ 42,811,948,493	18.38%	
Preparing for Audit			
Army, GF	\$ 62,710,234,121	26.92%	Category 1
Air Force, GF	\$ 58,992,240,227	25.32%	Category 1
Navy, GF	\$ 30,142,398,720	12.94%	Category 1
United States Marine Corps, GF and WCF	\$ 8,864,932,000	3.81%	Category 1
Navy, WCF	\$ 6,979,369,034	3.00%	Category 1
Office of the Secretary of Defense (WHS)	\$ 6,076,406,386	2.61%	Category 2
Pentagon Reservation Maintenance Revolving Fund (WHS)	\$ 3,713,833,098	1.59%	Category 2
UNAL/DIS - DoD Component Level Accounts (USD(C))	\$ 3,329,421,249	1.43%	Category 2
Defense Logistics Agency, WCF	\$ 2,216,339,000	0.95%	Category 2
Army, WCF	\$ 1,716,082,172	0.74%	Category 1
U.S. Special Operations Command	\$ 1,159,054,000	0.50%	Category 2
Air Force, WCF	\$ 1,032,181,097	0.44%	Category 1
Missile Defense Agency	\$ 833,762,000	0.36%	Category 2
Service Medical Activity	\$ 665,634,000	0.29%	Category 2
Subtotal Preparing for Audit	\$ 188,431,887,104	80.89%	
Immaterial Reporting Entities	\$ 1,710,864,403	0.73%	Category 3
Total	\$ 232,954,700,000	100.00%	
<ul style="list-style-type: none"> • Reporting entities in Category 1 will perform all audit readiness phases (i.e., Discovery, Corrective Action, Assertion/Evaluation, Validation, and Audit). However, reporting entities in Category 2 will stop after performing the Validation phase. • Reporting entities in Category 2 are allowed to procure audits if they desire to do so. 			

Figure 4. FY 2009 Material Reporting Entities for Real Property

General Equipment

Organization	General Equipment - Acquisition Value (FY 2009) Dollars in Thousand	Percent of Balance	Planned Audit Type
Under Audit			
US Army Corps of Engineers - Civil Works	\$ 1,524,212,842	1.89%	Category 1
Defense Finance and Accounting Service	\$ 313,036,000	0.39%	Category 2
Defense Commissary Agency, GF & WCF	\$ 151,636,000	0.19%	Category 2
Defense Contract Audit Agency, GF	\$ 124,000	0.00%	Category 2
Subtotal Under Audit	\$ 1,989,008,842	2.46%	
Preparing for Audit			
Air Force, GF	\$ 41,527,663,603	51.47%	Category 1
Navy, GF	\$ 11,171,172,875	13.84%	Category 1
U.S. Special Operations Command	\$ 7,361,202,000	9.12%	Category 1
Army, GF p	\$ 3,984,679,227	4.94%	Category 1
Accounts (USD(C))	\$ 3,187,970,418	3.95%	Category 2
Navy, WCF	\$ 2,552,894,521	3.16%	Category 1
Defense Information Systems Agency, GF & WCF	\$ 2,483,411,000	3.08%	Category 2
Air Force, WCF	\$ 2,351,361,179	2.91%	Category 1
Army, WCF	\$ 1,595,058,051	1.98%	Category 1
Defense Logistics Agency, WCF	\$ 657,425,000	0.81%	Category 2
United States Marine Corps, GF & WCF	\$ 465,519,000	0.58%	Category 1
Tricare Management Activity	\$ 438,041,000	0.54%	Category 2
Washington Headquarter Services	\$ 196,903,282	0.24%	Category 2
Subtotal Preparing for Audit	\$ 77,973,301,157	96.63%	
Immaterial Reporting Entities	\$ 728,390,001	0.90%	Category 3
Total	\$ 80,690,700,000	100.00%	
<ul style="list-style-type: none"> • Reporting entities in Category 1 will perform all audit readiness phases (i.e., Discovery, Corrective Action, Assertion/Evaluation, Validation, and Audit). However, reporting entities in Category 2 will stop after performing the Validation phase. • Reporting entities in Category 2 are allowed to procure audits if they desire to do so. 			

Figure 5. FY 2009 Material Reporting Entities for General Equipment

Inventory and Related Property

Organization	Inventory (FY 2009) Dollars in Thousand	Percent of Balance	Planned Audit Type
Under Audit			
Defense Commissary Agency, WCF	\$ 400,397,000	0.48%	Category 2
US Army Corps of Engineers - Civil Works	\$ 36,860,000	0.04%	Category 1
Subtotal Under Audit	\$ 437,257,000	0.53%	
Preparing for Audit			
Air Force, WCF	\$ 29,915,921,000	36.12%	Category 1
Army, WCF	\$ 23,164,252,000	27.97%	Category 1
Defense Logistics Agency, WCF	\$ 17,340,386,000	20.94%	Category 2
Navy, WCF	\$ 11,793,983,000	14.24%	Category 1
United States Marine Corps, WCF	\$ 157,599,000	0.19%	Category 1
Subtotal Preparing for Audit	\$ 82,372,141,000	99.47%	
Immaterial Reporting Entities	\$ 5,202,000	0.01%	Category 3
Total	\$ 82,814,600,000	100.00%	
* Reporting entities in Category 1 will perform all audit readiness phases (i.e., Discovery, Corrective Action, Assertion/Evaluation, Validation and Audit. However, reporting entities in Category 2 will stop after performing the Validation phase.			
* Reporting entities in Category 2 are allowed to procure audits if they desire to do so.			

Figure 6. FY 2009 Material Reporting Entities for Inventory and Related Property

Operating Materiel & Supplies (OM&S)

Organization	OM&S (FY 2009) Dollars in Thousand	Percent of Balance	Planned Audit Type
Under Audit			
US Army Corps of Engineers - Civil Works	\$ 95,570,000	0.07%	Category 1
Subtotal Under Audit	\$ 95,570,000	0.07%	
Preparing for Audit			
Navy, GF	\$ 56,614,797,000	38.98%	Category 1
Air Force, GF	\$ 47,588,283,000	32.76%	Category 1
Army, GF	\$ 34,497,598,000	23.75%	Category 1
United States Marine Corps, GF & WCF	\$ 5,905,146,000	4.07%	Category 1
Air Force, WCF	\$ 143,417,000	0.10%	Category 1
Navy, WCF	\$ 128,846,000	0.09%	Category 1
Subtotal Preparing for Audit	\$ 144,878,087,000	99.74%	
Immaterial Reporting Entities	\$ 284,743,000	0.20%	Category 3
Total	\$ 145,258,400,000	100.00%	
* Reporting entities in Category 1 will perform all audit readiness phases (i.e., Discovery, Corrective Action, Assertion/Evaluation, Validation and Audit. However, reporting entities in Category 2 will stop after performing the Validation phase.			
* Reporting entities in Category 2 are allowed to procure audits if they desire to do so.			

Figure 7. FY 2009 Material Reporting Entities for Operating Material & Supplies

The Department is dependent on many reporting entities reaching coverage totaling nearly 100 percent of assets to achieve auditable Department-wide Property, Plant, and Equipment (PP&E), Inventory, and Operating Material and Supplies (OM&S) balances. All reporting entities that are material by asset category have been specifically identified in the preceding tables.

The remaining entities, summarized on the "Immaterial Reporting Entities" line in each table, are deemed immaterial to the Department based upon current reported account balances. While these immaterial reporting entities should follow the FIAR guidance to become audit ready, they are not required to report their progress to the FIAR Directorate. The OUSD(C) will regularly update this analysis to confirm that all reporting entities material to the Department are appropriately identified and focused on performing audit readiness activities. The OUSD(C) will communicate the updated analyses separate from this guidance.

WAVE 4

All reporting entity financial statement line items needed to achieve coverage of at least 99 percent of the Department's material financial statement line items, are designated as material reporting entity line items that must be addressed in Wave 4. The Department has concluded that all amounts greater than one percent are considered material; therefore, the Department must ensure that at least 99 percent of the amounts reported are audit ready prior to asserting Department-wide audit readiness. This materiality threshold ensures the Department is focusing its limited resources on its significant reporting entities.

A three-step analysis was completed to identify all material reporting entity line items that must be addressed in wave 4. This three-step analysis was comprised of: (1) Identification of material financial statement line items on the Balance Sheet, Statement of Net Cost and Statement of Changes in Net Position (Statement of Budgetary Resources was fully addressed in Wave 2); (2) Identification of reporting entities that are material to the Department-wide financial statement line items identified in Step 1; and (3) exclusion of reporting entity line items (or activities) that were addressed in an earlier wave. The following tables summarize the results of the analysis performed, and further identify reporting entities that are currently undergoing audits or are preparing for an audit.

Note: The material reporting entities analysis performed for Wave 4 included below is based on FY 2010 financial statement reported amounts.

Military Retirement & Other Federal Employee Benefits

Reporting Entities	Military Retirement & Other Fed. Empl. Ben. (FY 2010)	Percent of Balance	Planned Audit Type
Under Audit			
Military Retirement Trust Fund	\$ 1,262,672,927,029	58.01%	Category 1
Medicare -Eligible Retiree Health Care Fund	\$ 573,671,310,000	26.36%	Category 2
Tricare Management Activity – CRM	\$ 256,490,931,721	11.78%	Category 2
U.S. Army Corps of Engineers – Civil Works	\$ 243,459,734	0.01%	Category 1
Defense Commissary Agency	\$ 167,221,475	0.01%	Category 2
Defense Finance and Accounting Service	\$ 39,804,072	0.00%	Category 2
Defense Contract Audit Agency	\$ 16,127,453	0.00%	Category 2
Subtotal Under Audit	\$ 2,093,301,781,484	96.17%	
Preparing for Audit			
Service Medical Activity	\$ 74,760,305,753	3.43%	Category 2
United States Marine Corps, GF	\$ 196,374,009	0.01%	Category 1
Subtotal Preparing for Audit	\$ 74,956,679,762	3.44%	
Immaterial Reporting Entities	\$ 8,440,280,879	0.39%	Category 3
TOTAL	\$ 2,176,698,742,126	100.00%	
<ul style="list-style-type: none"> Reporting entities in Category 1 will perform all audit readiness phases (i.e., Discovery, Corrective Action, Assertion/Evaluation, Validation, and Audit). However, reporting entities in Category 2 will stop after performing the Validation phase. Reporting entities in Category 2 are allowed to procure audits if they desire to do so. 			

Figure 8. FY 2010 Material Reporting Entities for Military Retirement & Other Federal Employee Benefits

Environmental & Disposal Liability

Reporting Entities	Environmental & Disposal Liability (FY 2010)	Percent of Balance	Planned Audit Type
Under Audit			
U.S. Army Corps of Engineers – Civil Works	\$ 1,038,121,750	1.65%	Category 1
Defense Commissary Agency	\$ 31,017,837	0.05%	Category 2
Subtotal Under Audit	\$ 1,069,139,587	1.70%	
Preparing for Audit			
Army, GF	\$ 33,352,730,535	53.02%	Category 1
Navy, GF	\$ 19,072,451,611	30.32%	Category 1
Air Force, GF	\$ 8,839,352,000	14.05%	Category 1
United States Marine Corps, GF	\$ 261,443,270	0.42%	Category 1
Subtotal Preparing for Audit	\$ 61,525,977,416	97.81%	
Immaterial Reporting Entities	\$ 307,074,347	0.49%	Category 3
TOTAL	\$ 62,902,191,350	100.00%	
<ul style="list-style-type: none"> Reporting entities in Category 1 will perform all audit readiness phases (i.e., Discovery, Corrective Action, Assertion/Evaluation, Validation, and Audit). However, reporting entities in Category 2 will stop after performing the Validation phase. Reporting entities in Category 2 are allowed to procure audits if they desire to do so. 			

Figure 9. FY 2010 Material Reporting Entities for Environmental & Disposal Liability

Other Liabilities – Intragovernmental

Reporting Entities	Other Liabilities-Intragovernmental (FY 2010)	Percent of Balance	Planned Audit Type
Under Audit			
U.S. Army Corps of Engineers – Civil Works	\$ 3,511,004,929	25.48%	Category 1
Subtotal Under Audit	\$ 3,511,004,929	25.48%	
Preparing for Audit			
Navy, GF	\$ 4,621,000,819	33.53%	Category 1
Army, GF	\$ 2,923,569,447	21.21%	Category 1
Air Force, GF	\$ 1,505,285,035	10.92%	Category 1
Navy, WCF	\$ 423,621,223	3.07%	Category 1
United States Marine Corps, GF	\$ 372,427,968	2.70%	Category 1
Under Secretary of Defense (Personnel and Readiness)	\$ 120,038,774	0.87%	Category 2
Under Secretary of Defense (Acquisition, Technology and Logistics)	\$ 74,586,620	0.54%	Category 2
Army, WCF	\$ 63,418,442	0.46%	Category 1
Subtotal Preparing for Audit	\$ 10,103,948,327	73.32%	
Immaterial Reporting Entities	\$ 166,511,746	0.86%	Category 3
TOTAL	\$ 13,781,465,003	100%	
<ul style="list-style-type: none"> Reporting entities in Category 1 will perform all audit readiness phases (i.e., Discovery, Corrective Action, Assertion/Evaluation, Validation, and Audit). However, reporting entities in Category 2 will stop after performing the Validation phase. Reporting entities in Category 2 are allowed to procure audits if they desire to do so. 			

Figure 10. FY 2010 Material Reporting Entities for Other Liabilities-Intragovernmental

Other Liabilities – Nonfederal

Reporting Entities	Other Liabilities-Nonfederal (FY 2010)	Percent of Balance	Planned Audit Type
Under Audit			
U.S. Army Corps of Engineers – Civil Works	\$ 2,173,317,729	6.11%	Category 1
Defense Finance and Accounting Service	\$ 111,701,727	0.31%	Category 2
Defense Commissary Agency	\$ 100,757,131	0.28%	Category 2
Defense Contract Audit Agency	\$ 54,401,261	0.15%	Category 2
Defense Information Systems Agency, WCF	\$ 42,431,011	0.12%	Category 2
Subtotal Under Audit	\$ 2,482,608,858	6.98%	
Preparing for Audit			
Army, GF	\$ 13,532,369,598	38.05%	Category 1
Air Force, GF	\$ 6,402,702,144	18.00%	Category 1
Navy, GF	\$ 5,412,207,197	15.22%	Category 1
Navy, WCF	\$ 1,752,327,879	4.93%	Category 1
DoD Component Level Accounts	\$ 1,603,698,613	4.51%	Category 2
United States Marine Corps, GF	\$ 1,461,335,095	4.11%	Category 1
Air Force, WCF	\$ 429,768,556	1.21%	Category 1
Office of the Secretary of Defense	\$ 394,691,563	1.11%	Category 2
Other 97 Funds Provided to the Army by OSD	\$ 387,975,489	1.09%	Category 2
Army, WCF	\$ 377,082,216	1.06%	Category 1
Service Medical Activity	\$ 296,806,261	0.83%	Category 2
Defense Logistics Agency, WCF	\$ 278,809,604	0.78%	Category 2
Defense Contract Management Agency	\$ 144,699,005	0.41%	Category 2
U.S. Special Operations Command	\$ 94,565,357	0.27%	Category 2
DoD Education Activity	\$ 63,002,902	0.18%	Category 2
Defense Information Systems Agency, GF	\$ 61,385,598	0.17%	Category 2
Missile Defense Agency	\$ 44,738,563	0.13%	Category 2
Subtotal Preparing for Audit	\$ 32,738,165,642	92.06%	
Immaterial Reporting Entities	\$ 342,752,244	0.96%	Category 3
TOTAL	\$ 35,563,526,744	100.00%	
<ul style="list-style-type: none"> Reporting entities in Category 1 will perform all audit readiness phases (i.e., Discovery, Corrective Action, Assertion/Evaluation, Validation, and Audit). However, reporting entities in Category 2 will stop after performing the Validation phase. Reporting entities in Category 2 are allowed to procure audits if they desire to do so. 			

Figure 11. FY 2010 Material Reporting Entities for Other Liabilities-Nonfederal

Losses / (Gains) from Actuarial Assumption Changes

Reporting Entities	Losses/(Gains) from Actuarial Assumption Changes (FY 2010)	Percent of Balance	Planned Audit Type
Under Audit			
Military Retirement Fund	\$ 85,006,894,000	51.81%	Category 2
Medicare -Eligible Retiree Health Care Fund	\$ 63,528,740,000	38.72%	Category 2
Tricare Management Activity - CRM	\$ 10,804,407,000	6.58%	Category 2
Subtotal Under Audit	\$ 159,340,041,000	97.11%	
Preparing for Audit			
Service Medical Activity	\$ 4,728,559,000	2.88%	Category 2
Subtotal Preparing for Audit	\$ 4,728,559,000	2.88%	
Immaterial Reporting Entities	\$ 20,469,000	0.01%	Category 3
TOTAL	\$ 164,089,069,000	100.00%	
<ul style="list-style-type: none"> Reporting entities in Category 1 will perform all audit readiness phases (i.e., Discovery, Corrective Action, Assertion/Evaluation, Validation, and Audit). However, reporting entities in Category 2 will stop after performing the Validation phase. Reporting entities in Category 2 are allowed to procure audits if they desire to do so. 			

Figure 12. FY 2010 Material Reporting Entities for Losses/ (Gains) from Actuarial Assumption Changes

APPENDIX B – ROLES AND RESPONSIBILITIES

As noted in Section 2.I, the Financial Improvement and Audit Readiness (FIAR) Governance Board plays a significant role in the Department's audit readiness effort. This appendix includes a description of additional key stakeholders and governing bodies for financial improvement and audit readiness.

B.1 KEY DEPARTMENTAL STAKEHOLDERS

B.1.1 Office of the Deputy Chief Management Officer (DCMO)

The DCMO leads and integrates Enterprise-wide performance improvement and business operations to enable and support the war fighter. The creation of the DCMO and Military Department CMOs is assisting with driving and measuring financial management results. These offices are actively coordinating and marshaling resources from across the Department in support of the Office of the Undersecretary of Defense (Comptroller) (USD(C)) financial improvement efforts and emphasizing the need to think of our business from an end-to-end process perspective.

One of the key financial improvement roles the DCMO and Military Department CMOs play is ensuring that functional communities (e.g., Logistics and Human Resources) recognize their vital role in achieving audit readiness, since most financial transactions originate as the result of business events in the functional community's operations. The Department has worked for years to fully engage functional communities in addressing auditability with varying success, but with the assistance of the DCMO and the Military Department CMOs, this is expected to improve. They also are providing the unifying support and oversight needed to ensure that business system modernization efforts are fully synchronized with reporting entity financial improvement activities depicted in their Financial Improvement Plans (FIPs). To date, linking these two initiatives has been difficult because of the compartmentalized nature of the two efforts.

As Principal Staff Assistant (PSA) to the Secretary of Defense, the DCMO also provided oversight of the Business Transformation Agency (BTA), a Defense Agency which helped facilitate transformation of the Department's financial processes and systems. However, as a result of the Secretary of Defense's efficiency initiative this past year, the decision was made to disestablish the BTA and incorporate its core functions into the DCMO and its direct program management responsibilities for specific enterprise defense business systems into the Defense Logistics Agency (DLA). The expanded ODCMO will continue to support FIAR efforts.

B.1.2 USD(C)/Chief Financial Officer (CFO)

The USD(C)/CFO is charged with the responsibility of developing and implementing Department of Defense (DoD)-wide financial management systems and overseeing financial management activities relating to CFO programs and operations of the DoD.

The CFO's oversight responsibilities include: (1) establishing financial management policies for the DoD, including its reporting entity parts; (2) ensuring compliance throughout the DoD with applicable accounting policies, standards and principles, as well as financial information and systems functional standards; (3) establishing, reviewing, and enforcing internal control policies, standards, and compliance guidelines involving financial management; (4) providing oversight of financial management activities and operations, including (a) preparation and revision of the FIAR Plan and the FIAR Plan Status Report and (b) oversee and execute the development of financial management budgets; (5) oversee adequate financial controls over real property, equipment and inventories; and (6) ensuring that complete, reliable, consistent, timely and accurate information on all transactions is available in financial management systems. *[See DoD Directive 5118.03, Under Secretary of Defense (Comptroller) (USD(C))/Chief Financial Officer (CFO), Department of Defense]*

B.1.3 USD(C)/Deputy Chief Financial Officer (DCFO)

The DCFO is responsible for overseeing and implementing accounting policy, improvements in financial management, as well as other financial management functions for the DoD on a day-to-day basis. To discharge his or her responsibilities, the DCFO has three Directorates: FIAR, Accounting and Finance Policy (A&FP), and the Business Integration Office (BIO).

FIAR Directorate

The FIAR Directorate, created by the USD(C), provides day-to-day management of the FIAR Plan to ensure that DoD-wide financial improvement efforts are integrated with functional community improvement activities. The FIAR Directorate:

- Recommends strategic direction to the DCFO and USD(C),
- Assists the DoD Components by evaluating FIAR plans, products and deliverables, as well as providing subject matter experts to assist in Component FIAR activities,
- Develops and issues detailed financial improvement and audit preparation methodologies and guidance,
- Organizes and convenes cross-Component financial and functional working groups to address issues and develop solutions,
- Utilizing experienced financial, accounting and auditing personnel, embeds teams to develop, improve, and execute Financial Improvement Plans (FIPs) and provide training to the Components,
- Biannually, publishes the FIAR Plan Status Report,
- Maintains the FIAR Planning Tool, which is used by the Components to manage their FIPs,
- Monthly, performs detailed reviews of the Component FIPs supported by the OUSD Acquisition, Technology and Logistics (AT&L) and provides feedback to the Components, as needed, and
- Develops metrics for monitoring and reporting progress.

Accounting and Finance Policy Directorate

A&FP Directorate is primarily responsible for accounting and finance policy within the DoD. The Directorate manages the content and publication of the DoD Financial Management Regulation (FMR), writes accounting and finance policies, and publishes policies written by others. The Directorate works closely with the FIAR Directorate to address critical accounting and financial management policy challenges throughout the Department.

Business Integration Office

BIO ensures that the Department's business and financial systems and process transformation plans are aligned with USD(C) goals and objectives and consistent with Federal requirements. BIO provides functional oversight during business system implementations to ensure appropriate controls are in place and that systems conform to applicable legislation such as the Federal Managers' Financial Integrity Act (FMFIA), the Federal Financial Management Improvement Act (FFMIA); and that functional priorities and requirements are consistent with DoD enterprise standards (e.g., Business Enterprise Architecture, Standard Financial Information Structure (SFIS)). BIO mission areas include: Enterprise System Support (e.g., Defense Agencies Initiative (DAI), Business Enterprise Information Services (BEIS)), Systems Oversight/Compliance/Institutional Review Board (IRB) Support, Business Systems Modernization and Process Transformation, and Metrics.

B.1.4 USD (Acquisitions, Technology & Logistics) (AT&L)

Assistant Secretary of Defense (Logistics and Materiel Readiness)

The Assistant Secretary of Defense (Logistics and Materiel Readiness) (ASD(L&MR)) serves as the principal staff assistant and advisor to the USD(AT&L), Deputy Secretary of Defense, and Secretary of Defense on logistics and materiel readiness in the Department and is the principal logistics official within the senior management of the DoD. In this capacity, the ASD(L&MR):

- Prescribes policies and procedures for the conduct of logistics, maintenance, materiel readiness, strategic mobility, and sustainment support in the DoD, to include, supply, maintenance, and transportation.

- Advises and assists the USD(AT&L), Secretary of Defense, and Deputy Secretary of Defense in providing guidance to the Secretaries of the Military Departments with respect to logistics, maintenance, materiel readiness, strategic mobility, and sustainment support in the DoD.
- Monitors and reviews all logistics, maintenance, materiel readiness, strategic mobility, and sustainment support programs.
- Participates in the DoD Planning, Programming, and Budgeting System.

Deputy Under Secretary of Defense (Installations and Environment)

The mission of the Office of the Deputy Under Secretary of Defense (Installations and Environment) (DUSD(I&E)) is to provide installation assets and services necessary to support our military forces in a cost effective, safe, sustainable, and environmentally sound manner. DUSD(I&E) provides oversight for DoD Environmental, Safety and Occupational Health (ESOH) programs, and issues ESOH asset management policy for use by the DoD Components in planning, programming, and budgeting. DUSD(I&E) focuses on modernizing business processes and supporting information technology to enable integrated and sustainable real property asset management. Among other things, DUSD(I&E) establishes policies for standardized processes and data elements for collecting and managing real property inventory information, developing and using unique identifiers for all real property sites and assets, and standardized practices for the accounting for environmental liabilities.

Property & Equipment Policy Office

The mission of the Property & Equipment Policy Office (P&EP) is to establish policies and support business process development that enables reporting entities (military services and defense agencies) to provide more accurate and reliable information to senior leaders to support management decisions at an enterprise-level. The P&EP Office focuses on improving the Department's property, plant and equipment (PP&E) business practices, policies, procedures and systems through constant interaction with reporting entities, as well as the DoD OIG and USD(C), including assisting with feedback on Existence and Completeness (E&C) plans. P&EP is the lead USD(AT&L) office for supporting the E&C effort regarding general and military equipment. P&EP assists the Components in evaluating whether their inventories for Quick Win assets meet the requirements for E&C assertion. P&EP is also the DoD lead for Military Equipment Valuation (MEV), which is a DoD-wide effort to implement Federal accounting standards requiring military equipment, including modifications and upgrades, to be treated as capitalized assets on the DoD financial statements.

B.1.5 Defense Finance and Accounting Service (DFAS)

DFAS operates most finance and accounting systems and functions for all appropriated, nonappropriated, working capital, revolving, and trust fund activities, including security assistance. DFAS establishes and enforces requirements, procedures, and practices necessary to comply with finance and accounting statutory and regulatory requirements applicable to DoD. DFAS also provides professional finance and accounting services for DoD reporting entities and other Federal agencies. DFAS also directs the consolidation, standardization, and integration of finance and accounting requirements, functions, procedures, operations, and systems and ensures their proper relationship with other DoD functional areas (e.g., budget, personnel, logistics, acquisition, civil engineering, etc.). DFAS executes statutory and regulatory financial reporting requirements and prepares financial statements. **[See DoD Directive 5118.5, Defense Finance and Accounting Service]**

B.1.6 Major Commands and Service Providers

The Components' major commands and service providers, such as the Army Materiel Command (AMC) and DFAS, execute the FIPs. The major commands and service providers perform the discovery work, test and strengthen internal controls, and correct deficiencies. It is within the major commands where business events occur that trigger financial transactions, and where the functional community engages with the financial community to achieve the vision, goals, and priorities of the FIAR Plan.

B.1.7 Department of Defense Office of Inspector General (DoD OIG)

The DoD OIG performs audits of the finance and accounting systems, functions, and activities established to carry out DoD fiscal responsibilities. The DoD OIG is involved in the FIAR Methodology during the Assertion / Evaluation, Validation and Audit phases as follows:

- *Assertion / Evaluation phase*- Once a reporting entity completes and asserts audit readiness for Waves 2, 3 and 4, the DoD OIG will perform an examination of the audit readiness assertion or review assertion examinations completed by the work of other Independent Public Accountants (IPA) for individual assessable units within these waves.
- *Validation phase*- The DoD OIG and FIAR Directorate review the examination report and additional documentation provided by the reporting entity demonstrating remediation of deficiencies noted during the examination, and make a final determination of the reporting entity's audit readiness state.
- *Audit Phase*- The DoD OIG either performs the audit or engages an IPA to assist with the audit. When an IPA is utilized, the DoD OIG provides oversight of audit work and either signs the opinion or transmits the IPA's opinion on the financial statements. **[See DoD Directive 5106.01, Inspector General of the Department of Defense]**

B.1.8 Reporting Entities's Senior Assessment Teams

Each reporting entity is required to have a Senior Assessment Team (SAT) that oversees the execution of the Strategy and Methodology. The primary responsibilities of the reporting entity's SAT include:

- Ensuring the FIAR Goal and Strategy are clearly communicated throughout the reporting entity;
- Ensuring that the Methodology is carried out in a thorough, effective, and timely manner (effective project management);
- Reporting the results of the execution of the FIAR Strategy and Methodology to senior management;
- Ensuring that personnel executing the FIAR Methodology are adequately trained;
- Monitoring the timely implementation of corrective actions; and
- Complying with ICOFR SOA annual reporting requirements (discussed in Section 2.D).

B.2 KEY BOARDS AND COMMITTEES

B.2.1 DoD Audit Advisory Committee

The DoD Audit Advisory Committee, established under the provisions of the Federal Advisory Committee Act of 1972, provides the Secretary of Defense, through the USD(C), independent advice and recommendations on DoD financial management, to include financial reporting processes, internal controls, audit processes, and processes for monitoring compliance with relevant laws and regulations. The Committee is comprised of three members, who are distinguished members of the audit, accounting, and financial communities. The members are not DoD employees. The Committee meets at the call of the USD(C). As needed, the Committee can establish subcommittees or workgroups to study, analyze, or address audit readiness issues and make recommendations to the Committee.

B.2.2 FIAR Committee

The FIAR Committee meets monthly to oversee the management of the FIAR Plan. The Committee leads the implementation of the FIAR Plan priorities. Chaired by the Deputy Chief Financial Officer (DCFO), the Committee is comprised of executive-level representatives of the OUSD (AT&L), Military Departments, Defense Logistics Agency (DLA) and Defense Finance and Accounting Service (DFAS). The Deputy Inspector General for Auditing acts as an adviser to the FIAR Committee.

B.2.3 FIAR Subcommittee

An active FIAR Subcommittee of senior accountants, financial managers, management analysts, and auditors support the FIAR Committee. The FIAR Director chairs the subcommittee that supports the FIAR Committee in its efforts to improve financial management within the Department. It also supports the integration of financial management requirements within the financial community and functional communities (Logistics, Acquisition, Personnel, etc.).

The Sub-Committee provides advice and recommendations to the FIAR Committee on opportunities to prioritize, integrate and manage efforts to improve financial management and achieve audit readiness. Management of these improvement efforts employs a federated approach that identifies enterprise requirements and recognizes unique reporting entity-level execution and implementation plans. Improvements focus on human capital requirements, policies, processes, controls, systems, and organizational structures.

APPENDIX C – FIAR STRATEGY DETAILS

This appendix provides FIAR Strategy details for reporting entities and service providers working to become audit ready. Organized by wave, this appendix includes specific key Risks of Material Misstatements (ROMMs), Financial Reporting Objectives (FROs) and Key Supporting Documents (KSDs) for each wave.

C.1 WAVE 1 – APPROPRIATIONS RECEIVED AUDIT

The DoD FMR 7000.14, Volume 6B, Chapter 7 defines appropriations (SBR line 1290, Appropriations (discretionary and mandatory) (formerly SBR Line 3A) as "... the amount of appropriations specified in the appropriations act or in substantive laws that become available for obligation on or after October 1 of the fiscal year (actual and anticipated)." Therefore, Wave 1 represents all budgetary funding appropriated from Congress and the related first level of funding distribution for the reporting entity's use.

C.1.1 Readiness Scope

To successfully prepare for an Appropriations Received audit, Wave 1 reporting entity readiness efforts must include all processes that result in financial transactions material to recording and distributing budget authority. This typically includes:

- Funding appropriated by Congress for the current fiscal year,
- Apportionment/re-apportionment activity approved by the OMB,
- Department-level allotment and reprogramming activity,
- Reporting entity-level allotment and reprogramming activity, and
- Treasury warrants documenting the availability of Fund Balance with Treasury (FBWT).

These processes include the receipt of congressional appropriations, the accurate apportionment of the funds, the proper dissemination of the funding apportionments downward, the recording in general ledgers, and finally, the reporting on the reporting entity financial statements. Specifically, this would include actions the Office of the Under Secretary of Defense (Comptroller) (OUSD(C)) or reporting entity headquarters takes to make the funding allocations flow from headquarters to the responsible manager at the installation level, as well as actions taken by Defense Finance and Accounting Services (DFAS) to prepare the financial statements.

Wave 1 processes and related controls include activities performed to control and record transactions related to: (1) the receipt of the budget ("Appropriations Received"), and (2) the distribution of the budget to the major command level.

Current year appropriations distribution includes the capability to support the completeness of funds distributed to the major command or equivalent. Reporting entities should demonstrate completeness of funds distribution by reconciling the current year budget authority apportioned and allotted to USSGL accounts 4510, "Apportionments", and 4610, "Allotments- Realized Resources", of the general ledger to the fund distribution system. The reconciliation should identify current year budget authority as an element of the entire balance, which includes beginning balances, reductions for executed funds and upward or downward adjustments, recorded in these accounts.

The first event is the receipt of the budget funding. This involves SBR Line 1290, Appropriations (discretionary and mandatory) and preparing that line item for audit. Financial events resulting from appropriations include an increase to the Appropriations line item on the SBR and a corresponding increase to FBWT on the proprietary side. Note that during the apportionment process (SF 132), not only are the actual and anticipated resources apportioned (such as appropriations supporting Line 1290), but also the actual and anticipated additions and reductions to resources (such as rescissions and general provision reductions, rescissions, and transfers).

The second area of importance is the distribution of the budget. While SBR Line 1290 reports appropriated resources received, the distribution of these resources, reported as changes to status within SBR lines 2204 (formerly SBR Line 9A) , 2304 (formerly SBR Line 9B) and 2404 (formerly SBR Line 10),

plays a critical role in each organization's funding and execution control activities. The evaluation of distribution controls for activity recorded to these status lines become a critical component of a comprehensive audit of the SBR. Success depends on **implementation of effective control activities** that mitigate the risk of potential misstatement within all material lines and account balances. In particular, effective control **activities** for receipt and distribution of funds aid in the prevention of Anti-Deficiency Act violations. These control **activities** also provide mid-year monitoring of spending to identify the need for reprogramming, transfers and/or journal vouchers as applicable. Refer to Section C.1.2 for a listing of KSDs used to demonstrate the accuracy of the transactions recorded and the control **activities** are in place.

C.1.2 Risks, Financial Reporting Objectives and Key Supporting Documents

Risks

The following table presents the key ROMM related to the Wave 1, Appropriations Received, by each of the five financial statement assertions. A reference to the source of each risk is included in parentheses. **Reporting entities must identify and implement a combination of control activities and supporting documentation to demonstrate that the FROs, relevant to the subject matter, assertion, or processes, (e.g., contract pay) have been achieved.** Refer to the FROs in the table following this risk table for further details.

Wave 1 – Appropriations Received Key Risks of Material Misstatement	
Financial Statement Assertions	Key Risks of Material Misstatement
Existence	1. Recorded budget authority does not exist (e.g., not authorized by Public Law) (FAM 395B: 4)
Completeness	2. All new budget authority made available for obligation was not recorded (GAO-02-126G; p. 26)
Valuation	3. New budget authority was recorded at incorrect amounts (GAO-02-126G; p. 25) 4. Apportionment amounts do not agree to the total appropriated amount (FAM 395F: 01b) 5. Allotted amounts do not agree to appropriated/apportioned amounts (FAM 395F: 01c)
Presentation and Disclosure	6. Accumulated accounts or transactions are not properly classified and described in the SBR and SF-133 (FAM 395B: 15) 7. The current period SBR is based on accounting principles different from those used in prior periods presented (FAM 395B: 16) 8. Information needed for fair presentation in accordance with U.S. GAAP is not disclosed in the financial statements (including OMB and FASAB guidance) (FAM 395B: 17)
Rights and Obligations	9. Agencies do not have rights to budgetary resources reported on the SBR (FAM 395F: 01a)

Financial Reporting Objectives

Reporting entities must achieve the FROs relevant to the subject matter, assertion, or processes (e.g., contract pay), to demonstrate audit readiness. Each FRO has been linked to its relevant financial statement assertions (as indicated with an "X" in the relevant columns), including if the FRO relates to compliance with laws and regulations. At the end of each FRO is a source reference. This is not a complete listing of control objectives, but rather those FROs needed to address key risk areas most likely to be present based on the Department of Defense's (Department or DoD) experience. **Reporting entities must apply judgment to determine if additional FROs should be included given their specific business processes and financial statements.** Reporting entities may also refer to the GAO/PCIE FAM Section 395B and 395F for a list of general control objectives based on financial statement assertions.

Wave 1 – Appropriations Received Financial Reporting Objectives						
Line Items	Financial Reporting Objectives	Financial Statement Assertions				Compliance
		Existence	Completeness	Valuation	Presentation & Disclosure	Rights & Obligations
Appropriations (discretionary and mandatory) Note: While not a part of Wave 1, these same FROs should be used for Borrowing Authority and Contract Authority, if applicable¹⁵	1. Appropriation transactions (or other forms of budget authority): Recorded appropriation (or other forms of budget authority) is the same as the appropriation or other legislation, that was made available for obligation (including restrictions on amount, purpose & timing) and pertains to the entity (FAM 395F: 01a)	x		x		x
	2. Appropriation transactions (or other forms of budget authority): All new budget authority that was made available for obligation was recorded in the proper accounts and properly summarized (GAO-02-126G; p. 26)	x	x		x	
	3. Apportionment transactions: Recorded apportionments agree with the OMB apportionments (as indicated on the apportionment schedules), and the total amount apportioned does not exceed the total amount appropriated (FAM 395F: 01b)	x		x		x
	4. Allotment and sub-allotment transactions: The total amount allotted does not exceed the total amount apportioned (FAM 395F: 01c)					x

Key Supporting Documents

The following table lists the minimum internal control documentation and supporting documentation required to assert as audit ready for Wave 1, Appropriations Received. The table links each listed document to the potential financial statement assertions that it supports. Internal control documentation is marked as meeting all financial statement assertions, because the specific control activities described in the internal control documentation will determine which specific financial statement assertions are satisfied. Specific to Wave 1 supporting documentation:

- Reporting entities must retain all internal control documentation that demonstrates the design and operation of processes and activities.
- Reporting entities must retain supporting documentation that constitutes financial transaction evidence substantiating the accuracy of all relevant financial statement assertions. For example, reporting entities must retain appropriation documentation for the life of the appropriation.

¹⁵ The format of new SBR now combines all types of budgetary authority including transfers and temporarily/permanently restricted. However, since all reporting entities have already asserted to Wave 1, the scope of Wave 1 will not change. Reporting entities will be responsible for achieving these FROs as part of their Wave 2 assessable unit assertions.

Wave 1 – Appropriations Received Key Supporting Documents							
Line Items	Documentation Type	Key Supporting Documents	Financial Statement Assertions				
			Existence	Completeness	Valuation	Presentation & Disclosure	Rights & Obligations
All Financial Statement Line Items	Internal Control Documentation	1. Statement-to-process analyses demonstrating the dollar amount and quantity of activity flowing through various processes and/or locations	x	x	x	x	x
		2. Applicable policies and procedures	x	x	x	x	x
		3. Process narratives and flowcharts	x	x	x	x	x
		4. Control worksheets, identifying risks, FROs and corresponding control activities	x	x	x	x	x
		5. Test plans documenting planned procedures used to test the operating effectiveness of control activities	x	x	x	x	x
		6. Control assessments with test results	x	x	x	x	x
		7. Evaluation of test results	x	x	x	x	x
		8. Documentation evidencing the operation of internal control activities for the period under audit. For example: <ul style="list-style-type: none">Approval signature documentation (electronic or manual) demonstrating accuracy reviews of appropriation transactions recorded in the general ledger (compared to supporting documentation such as Appropriation Act / Public Law)	x	x	x	x	x
		9. System inventory list, listing of system users and their access privileges.	x	x	x	x	x
Budgetary Authority: Appropriations	Transaction Documentation	10. Appropriation Act (Public Law)	x	x	x	x	x
		11. Treasury Warrants (FMS 6200)	x	x	x	x	x
		12. Apportionment and Reapportionment Schedule (SF 132)	x	x	x	x	x
		13. Funding Authorization Documents (FADs) supporting Departmental Allotments					x
		14. Reporting entity-level sub-allotment documentation (if applicable)					x
		15. Report on Budget Execution and Budgetary Resources (SF 133)				x	
		16. Trial balance by fund code (Treasury account) corresponding to each appropriation				x	
		17. Year-End Closing Statement (FMS 2108)				x	

C.1.3 Example Work Products

Refer to SBR Section C.2.3 for examples of SBR work products and related guidance.

C.1.4 Wave-Specific Audit Execution

Wave 1 reporting entity audit readiness efforts must include all processes that result in financial transactions material to the receipt and distribution (first level of distribution within the reporting entity) of budget authority. **Reporting entities must prepare and submit assertion documentation (i.e., risk assessments, control assessments, process narratives, test plans, etc.) to the FIAR Directorate as they complete the key tasks and activities in the Discovery and Corrective Action phases. The FIAR Directorate will review the assertion documentation and provide feedback to the reporting entities on an ongoing basis.** Once a reporting entity asserts audit readiness for Appropriations Received, the FIAR Directorate will validate that all key audit readiness dealbreakers (i.e., reconciled population, sufficient testing of control activities, etc.) have been sufficiently addressed. The FIAR Directorate will then engage an Independent Public Accountant (IPA) or the Department of Defense Office of Inspector General (DoD OIG) to perform an examination on the assessable unit's audit readiness assertion.

If the examination results in an unqualified opinion, the reporting entity will be required to sustain its audit readiness state for Appropriations Received until Wave 2 is complete and the reporting entity undergoes a full SBR audit. Appropriations Received is a key element of the SBR, and for the Military Departments, it has been validated as audit ready by an IPA firm. Appropriations Received was also asserted as audit ready by the Other Defense Organizations and an assertion examination will be performed during FY 2013.

C.2 WAVE 2 – SBR AUDIT

The SBR presents all budgetary resources that a reporting entity has available, the status of those resources at period end, a reconciliation of changes in obligated balances from the beginning to the end of the period, and cash collections and disbursements for the period reported. Wave 2 – SBR Audit includes all processes, internal controls, systems and supporting documentation that must be audit ready before asserting audit readiness for the SBR. Significant business cycles in this wave include Procure-to-Pay, Hire-to-Retire, Order-to-Cash, and Budget-to-Report (including FBWT).

C.2.1 Readiness Scope

To prepare for an SBR audit, a reporting entity's audit readiness efforts must include all processes that result in financial transactions material to their SBR. The financial transactions that are summarized and reported on the SBR also affect other financial statements. The most important relationships are those between the SBR and the Balance Sheet. Specifically, because of the strong relationship between the FBWT line item on the Balance Sheet and SBR line items, examples shown in Figure 1, the Department's strategy for the SBRs depends on an auditable FBWT balance. This includes not only cash collection and disbursement transactions that affect multiple SBR line items and the FBWT line item on the Balance Sheet, but also the Treasury reporting and reconciliation activities reporting entities perform to ensure their records remain in balance with the Treasury.

Example Financial Event	SBR Impact	Balance Sheet – FBWT Impact
Appropriation Received	Increase to Appropriation	Increase to FBWT
Rescissions	Increase to Permanently not Available	Decrease to FBWT
Unfilled Order Received with Advance	Increase to Unfilled Customer Orders	Increase to FBWT
Collection	Increase to Earned Spending Authority	Increase to FBWT
Disbursement	Increase to Gross Outlays	Decrease to FBWT

Figure 1. Relationship between SBR and FBWT

Wave 2 includes the SBR's main sections and the underlying financial transactions reported in each section and FBWT:

- *Budgetary Resources* – including recoveries of prior year unpaid obligations [SBR line 1021 (formerly SBR Line 1)], appropriations (addressed in Wave 1) [SBR line 1290], contract authority [SBR line 1690 (formerly SBR Lines 3C, 4, 5 and 6)], reimbursable activity [SBR line 1890 (formerly SBR Lines 3d3, 4, 5 and 6)], non-expenditure transfers [formerly SBR line 4] and rescissions [formerly SBR line 6], status of budgetary resources – including obligations incurred [SBR line 2190] under various procure-to-pay and hire-to-retain processes (vendor purchases, civilian and military payroll, travel, Military Interagency Purchase Requests (MIPRs), etc.), and ending unobligated balances [SBR lines 2204, 2304, and 2404],
- *Change in Obligated Balance* – including delivery of orders and the status of period-end balances for undelivered/delivered orders and unfilled customer orders/receivables from Federal sources [SBR lines 3000 through 3100 (formerly SBR Lines 12-18C)],
- *Budget Authority and Outlays, Net* – including cash disbursement and collection activity, along with distributed offsetting receipts [SBR lines 4175 through 4210 (formerly SBR Lines 19A-19D)], and
- *FBWT* – including aspects of FBWT such as appropriations (addressed in Wave 1), cash disbursements and collection (same as preceding bullet), monthly reconciliations of all open appropriation accounts at the transaction level, and reporting.

The preceding is not a complete list, but rather a listing of major transaction types contained within a typical SBR. Reporting entities should follow the FIAR Methodology to identify all processes that result in transactions and balances material to their SBR.

C.2.2 Risks, Financial Reporting Objectives, Assessable Unit Risks and Outcomes, and Key Supporting Documents

Risks

The following table presents the key ROMM related to the Wave 2, SBR Audit, by each of the five financial statement assertions. The second table contains the same information for FBWT. A reference to the source of each risk is included in parentheses. **Reporting entities must review the listing of the FROs; identify the FROs relevant to the subject matter, assertion, or processes (e.g., contract pay); and determine the combination of control activities and supporting documentation that must be implemented to achieve the FROs.** Refer to the FROs in separate tables following these risk tables for further details.

Financial Statement Assertions	Statement of Budgetary Resources Wave 2 – SBR Audit Key Risks of Material Misstatement
Existence	<ol style="list-style-type: none"> Recorded unobligated balances brought forward are not available for obligation in the current period because balances have been rescinded or are otherwise restricted (GAO-02-126G: p. 26) Recoveries of prior year obligations are incorrect or are no longer available (GAO-02-126G: p.28) Recorded budget authority does not exist (e.g., not authorized by Public Law) (FAM 395B: 4) Spending authority from offsetting collections do not exist, are not supported by an authorized agreement or are not yet earned (FAM 395B: 4) Recorded transfers are not properly authorized (FAM 395B: 1) Budgetary resources not available for obligation are not properly reported (GAO-02-126G: p. 29) Recorded obligations do not represent valid orders, contracts, or other events that will require future payment (GAO-02-126G: p. 31) Obligations are recorded in bulk amounts not supported by binding agreements (FAM 395F: 01e) Obligations are not properly liquidated when transactions are completed (GAO-02-126G: p. 34) Recorded outlays are for invalid or unauthorized transactions and/or are not supported by disbursement evidence (GAO-02-126G: p. 35). Recorded Collection or Receipt transactions are not valid or available for obligation during the year (GAO-02-126G: p. 27, 36) Transactions are recorded in the current period, but the related economic events occurred in a different period (FAM 395 B: 2)* Transactions are summarized improperly, resulting in an overstated total (FAM 395B: 3)*
Completeness	<ol style="list-style-type: none"> All unobligated available balances brought forward are not recorded (GAO-02-126G: p. 26) All recoveries of prior year obligations that are available for obligation are not recorded as recoveries in the SBR (GAO-02-126G: p. 28) All new budget authority made available for obligation was not recorded (GAO-02-126G: p. 26) All available and authorized spending authority is not recorded (GAO-02-126G: p. 27) Transfers are not recorded in the correct period (FAM 395B: 6) All canceled, restricted, or limited budgetary resources are not included as reductions on the SBR (GAO-02-126G: p. 27) All obligations incurred are not properly recorded (GAO-02-126G: p. 31) An agency may have placed an order for goods/services and not recorded the Undelivered Order (UDO) amount (GAO-02-126G: p. 34) Goods or services may have been received, but the Delivered Orders /Accounts Payable (AP) has not been recorded and Undelivered Order amount reduced (GAO-02-126G: p. 34) All appropriate outlays and adjustments are not recorded (FAM 395F: 01g) All valid and authorized collection or receipt transactions are not recorded (GAO-02-126G: p. 27, 36) Economic events occurred in the current period, but the related transactions are recorded in a different period (FAM 395B: 6)* Transactions are summarized improperly, resulting in an understated total (FAM 395B: 7)*
Valuation	<ol style="list-style-type: none"> Unobligated balances brought forward are recorded at incorrect amounts (GAO-02-126G: p. 26) Recoveries of prior year obligations are incorrectly calculated (GAO-02-126G: p. 28) New budget authority was recorded at incorrect amounts (GAO-02-126G: p. 25) Apportionment amounts do not agree to the total appropriated amount (FAM 395F: 01b) Allotted amounts do not agree to appropriated/apportioned amounts (FAM 395F: 01c) Spending authority from offsetting collections is not recorded at the correct amount (GAO-02-126G: p. 27) Transfers are not recorded at the correct amount (FAM 395B: 9) Budgetary resources temporarily or permanently not available for obligation are recorded at incorrect amounts (FAM 395B: 9) Obligations are not recorded at the proper amounts (GAO-02-126G: p. 31)

Financial Statement Assertions	Statement of Budgetary Resources Wave 2 – SBR Audit Key Risks of Material Misstatement
	35. Inaccurate Uncollected Customer Payments/Accounts Receivable (AR) and Unfilled Customer Order (UFCO) amounts are included in the obligated balance, net end of period (FAM 395F: 01e) 36. Outlays and adjustments are reported at incorrect amounts (FAM 395F: 01g) 37. Collections or Receipts are misstated (GAO-02-126G: p. 27, 35)
Presentation and Disclosure	38. Accumulated accounts or transactions are not properly classified and described in the SBR and SF-133 (FAM 395B: 15) 39. The current period SBR is based on accounting principles different from those used in prior periods presented (FAM 395B: 16) 40. Information needed for fair presentation in accordance with U.S. GAAP is not disclosed in the financial statements (including OMB and FASAB guidance) (FAM 395B: 17)
Rights and Obligations	41. Agencies do not have rights to budgetary resources reported on the SBR, including collection and/or receipt activity (FAM 395F: 01a) 42. Unobligated balances are misstated and expired balances or errors are carried forward into next year's balances (GAO-02-126G: p. 32) 43. UFCOs related to expired agreements are included in the uncollected customer payments balance (FAM 395B: 13) 44. Agency is not contractually or legally bound to the obligation and therefore, related outlays should not be made, recorded or reported (FAM 395F: 01j)
* Risk Applies to all SBR line items.	

Financial Statement Assertions	Fund Balance with Treasury Wave 2 – SBR Audit Key Risks of Material Misstatement
Existence	1. FBWT amounts recorded in the general ledger do not exist (FAM 921C: 1) 2. FBWT reconciliations to Treasury reports are not performed in a timely manner (FAM 395B: 3) 3. Unreconciled differences, including those that are temporarily recorded in budget clearing accounts are not researched and resolved in a timely manner (FAM 395B: 3)
Completeness	4. Increases/decreases to FBWT are not appropriately and completely recorded (FAM 395B: 5) 5. FBWT balance exists but is omitted from the financial statements (FAM 921C: 2)
Valuation	6. FBWT transactions are recorded at incorrect amounts (FAM 921C: 3)
Presentation and Disclosure	7. FBWT is not properly classified and described in the financial statements (FAM 921C: 6) 8. The current period FBWT is based on accounting principles different from those used in prior periods presented (FAM 921C: 7) 9. Information needed for fair presentation in accordance with U.S. GAAP is not disclosed in the financial statements (including OMB and FASAB guidance) (FAM 921C: 8)
Rights and Obligations	10. The entity does not have rights to the recorded FBWT amounts (FAM 921C: 5) 11. Recorded FBWT is owned by others (FAM 921C: 4)

Financial Reporting Objectives

Reporting entities must identify and implement a combination of control activities and supporting documentation to demonstrate that the FROs, relevant to the subject matter, assertion, or processes, (e.g., contract pay) have been achieved. Note that some SBR line items are listed more than once because different groups of FROs link to different combinations of line items. Therefore, it is important to review the entire table to ensure a complete list of FROs relevant to a particular assessable unit/line item. Each FRO has been linked to its relevant financial statement assertions (as indicated with an “X” in the relevant columns), including if the FRO relates to compliance with laws and regulations. At the end of each FRO is a source reference. This is not a complete listing of control objectives, but rather those FROs needed to address key risk areas most likely to be present based on the Department’s experience. **Reporting entities must apply judgment to determine if additional FROs should be included given their specific business processes and financial statements.** Reporting entities may also refer to the [GAO/PCIE FAM](#) Section 395B and 395F for a list of general control objectives based on financial statement assertions.

Statement of Budgetary Resources Wave 2 – SBR Audit Financial Reporting Objectives						
Line Items	Financial Reporting Objectives	Financial Statement Assertions				Compliance
		Existence	Completeness	Valuation	Presentation & Disclosure	Rights & Obligations
All Financial Statement Line Items	1. Accounts and all the transactions they accumulate are properly classified and described in the SBR and SF-133 (FAM 395B: 15)*				x	
	2. The current period SBR is based on accounting principles that are consistently applied from period to period (FAM 395B: 16)*				x	
	3. SBR and related footnotes contain all information needed for fair presentation in accordance with U.S. GAAP (FAM 395B: 17)*				x	
	4. Recorded transactions underlying events, and related processing procedures are authorized by federal laws, regulations, and management policy (FAM 395B: 1a)	x				
	5. Transactions recorded in the current period represent economic events that occurred during the current period (FAM 395B: 2)	x				
	6. The summarization of recorded transactions is not overstated (FAM 395B: 3)	x				
	7. All economic events that occurred in the current period are recorded as transactions in the current period (FAM 395B: 6)		x			
	8. The summarization of recorded transactions is not understated (FAM 395B: 7)		x			
Unobligated Balance, Brought Forward October 1	9. Recorded unobligated balances from prior periods remain available for obligation and pertains to the entity (GAO-02-126G: p. 26)	x				x
	10. All unobligated balances from prior periods are recorded and agree with prior year balances (GAO-02-126G: p. 27)		x	x		
Adjustments to unobligated balance brought forward, Oct 1						
Other changes in unobligated balances						
Recoveries of Prior Year Unpaid Obligations	11. Recorded recoveries represent cancellations or downward adjustments of prior obligations, remain available, are recorded in the proper accounts and pertains to the entity (GAO-02-126G: p. 28)	x			x	x
	12. All recoveries of prior years that are available for obligation were included in the SBR (GAO-02-126G: p. 28)		x			
Spending Authority from Offsetting Collections (discretionary and mandatory) Nonexpenditure Transfers, net, Anticipated and Actual Temporarily not Available Pursuant to Public Law Permanently not Available	13. Spending authority from offsetting collections (anticipated and accepted orders) is available for obligation during the year, was recorded in the proper accounts and pertains to the entity and is supported by proper documentation (GAO-02-126G: p. 27)	x			x	x
	14. All offsetting collections are available for obligation by reference to authorizing legislation (GAO-02-126G: p. 27)					x
	15. All revenue and collections are recorded in the proper accounts (GAO-02-126G: p. 27)		x		x	
	16. Spending authority from offsetting collections was reconciled to reported revenue from third parties (GAO-02-126G: p. 27)	x	x	x		x
	17. All available and authorized spending authority is recorded and at correct amounts (GAO-02-126G: p. 27)		x	x		
	18. Recorded non-expenditure transfers represent valid transfers authorized by OMB and pertain to the entity (FAM 395B: 1a)	x				x
	19. All transfers authorized by OMB are recorded in the proper period and at correct amounts (FAM 395B: 6, 9)		x	x		

Statement of Budgetary Resources Wave 2 – SBR Audit Financial Reporting Objectives						
Line Items	Financial Reporting Objectives	Financial Statement Assertions				
		Existence	Completeness	Valuation	Presentation & Disclosure	Rights & Obligations
	20. Reported amounts not available (temporarily or permanently) represent valid restrictions on the availability of budget authority or cancellations, pertain to the entity and are supported by available documentation (GAO-02-126G: p. 26)	x				x
	21. All amounts that are canceled, restricted, or limited are included as reductions of resources in the SBR (GAO-02-126G: p. 27)		x			
Recoveries of prior year unpaid obligations (for those FROs referencing “adjustments” to obligations) Obligations Incurred Unpaid Obligations, Brought Forward October 1 Unpaid Obligations, End of Period	22. Obligations represent valid orders that will require future payment (FAM 395F: 01e)	x				x
	23. Obligations are for the same purpose for which the appropriation was made (FAM 395F: 01e)					x
	24. Obligations are incurred within the time that the appropriation was available for new obligations (FAM 395F: 01e)				x	x
	25. Obligations do not exceed the amount allotted or appropriated by statute, nor were the obligations incurred before the appropriation became law (unless otherwise provided by law) (FAM 395F: 01e)				x	x
	26. Obligations comply with all other legally binding restrictions such as obligation ceilings or earmarks (FAM 395F: 01e)				x	
	27. Obligations are not subsequently cancelled nor have the goods or services been received (FAM 395F: 01e)	x			x	
	28. Adjustments represent a “contract change” as defined in OMB Circular A-11 (FAM 395F: 01e) and satisfy reporting and approval requirements in that circular					x
	29. Adjustments do not cause the entity to exceed the amount allotted or appropriated by statute (FAM 395F: 01e)					x
	30. Adjustments are recorded during the period when the account is available for adjustments (5 years) and was made for a valid obligation incurred before the authority expired (FAM 395F: 01e)	x			x	
	31. New obligations are not recorded in expired accounts (FAM 395F: 01e)				x	
	32. All new and valid obligations incurred during the period are recorded in the proper accounts (FAM 395F: 01e)		x		x	
	33. Obligations are recorded in the proper period (FAM 395F: 01e)	x	x			
	34. Obligations are recorded at the best available estimate of actual cost (FAM 395F: 01e)			x		
	35. Obligations are recorded in the proper appropriation or fund accounts (also by program and by object, if applicable), including the proper appropriation year if the account is multiyear (FAM 395F: 01e)				x	
	36. Commitment transactions: If commitment controls are relied upon to achieve objectives related to obligations and expenditures, commitment objectives are the same as obligations and expenditures (FAM 395F: 01d)					x
	37. Expended authority transactions recorded have occurred, as evidenced by appropriate supporting documentation (FAM 395F: 01f)	x				
	38. For expended authority transactions in expired accounts, transactions do not cause the entity to exceed the amount appropriated by statute (FAM 395F: 01f)					x
	39. For expended authority transactions in expired accounts, transactions are recorded during the period when the account is available for adjustment (5 years) (FAM 395F: 01f)					x
	40. For expended authority transactions in expired accounts, transactions are not made out of closed accounts (FAM 395F: 01f)					x

Statement of Budgetary Resources Wave 2 – SBR Audit Financial Reporting Objectives						
Line Items	Financial Reporting Objectives	Financial Statement Assertions				Compliance
		Existence	Completeness	Valuation	Presentation & Disclosure	Rights & Obligations
	41. All expended authority transactions and adjustments are recorded (FAM 395F: 01f)		x			
	42. Expended authority transactions and adjustments are recorded at the correct amount (FAM 395F: 01f)			x		
	43. Expended authority transactions and adjustments are recorded in the proper period (FAM 395F: 01f)	x	x			
	44. Expended authority transactions and adjustments are recorded in the proper appropriation or fund accounts (also by program and by object, if applicable), including the proper appropriation year if account is multiyear (FAM 395F: 01f)				x	
Unobligated Balance, end of year: Apportioned Unobligated Balance, end of year: Exempt from Apportionment Unobligated Balance, end of year: Unapportioned	45. Unobligated balances exist and represent available or not available (expired) funds and pertain to the entity (FAM 395B: 04a, 13)	x				x
	46. Unobligated balances do not include any expired, canceled, or rescinded amounts (GAO-02-126G: p. 32)	x				
	47. All unobligated funds are recorded (FAM 395B: 05)		x			
	48. Recorded balances as of a given date are supported by appropriate detailed records that are accurately summarized and reconciled to the appropriation or fund account balance, by year, for each account (FAM 395B: 4b)	x	x	x	x	
	49. Total undelivered orders plus total expended authority transactions do not exceed the amount of the appropriation or other statutory limitations (FAM 395F: 01h)					x
	50. Fixed appropriation accounts are closed on September 30 of the 5th fiscal year after the end of the period that they are available for obligation, any remaining balance (whether obligated or unobligated) is canceled and no longer available for obligation or expenditure for any purpose (FAM 395F: 01h)					x
	51. Indefinite appropriation accounts are closed if (1) the entity head or President determines the purpose of the appropriation has been carried out, and (2) no disbursements have been made for two consecutive fiscal years (FAM 395F: 01h)					x
Unpaid Obligations, Brought Forward October 1	52. Total payments of outstanding unliquidated obligations that relate to closed accounts do not exceed the limits described in OMB Circular No. A-11 (FAM 395F: 01h)					x
Unpaid Obligations, End of Period	53. Unpaid obligations and uncollected customer payments represent amounts for orders placed/received, contracts awarded, and similar obligating/ordering transactions for which goods and services have not been paid or agreements expired and pertain to the entity (FAM 395B: 01a, 14)	x				x
Uncollected customer payments from Federal Sources, Brought Forward October 1	54. All unpaid obligations and uncollected customer payments are recorded in the proper accounts, the correct fiscal year, the correct amount and are properly classified and presented in the financial statement (FAM 395B: 9, 15)			x	x	
Uncollected Customer Payments from Federal Sources, End of Period						

Statement of Budgetary Resources Wave 2 – SBR Audit Financial Reporting Objectives							
Line Items	Financial Reporting Objectives	Financial Statement Assertions					Compliance
		Existence	Completeness	Valuation	Presentation & Disclosure	Rights & Obligations	
Gross Outlays	55. Outlays represent valid, authorized transactions and pertain to the entity (FAM 395F: 01f)	x				x	
	56. Outlays are recorded against obligations made during the period of availability of the appropriation (as applicable) (FAM 395F: 01f)					x	x
	57. All outlays are recorded (FAM 395F: 01f)		x				
	58. Outlays are recorded at the correct amounts (FAM 395F: 01f)			x			
	59. Outlays are recorded in the proper accounts (by both program and by object, if applicable), including the proper appropriation year if the account is multiyear-evidenced by matching outlay to the underlying obligation (if applicable) (FAM 395F: 01f)				x		
	60. Outlays are recorded in the proper period (FAM 395F: 01f)	x	x				
	61. Recorded balances of outlay for the fiscal year are supported by appropriate detail records that are accurately summarized for each account (FAM 395F: 01i)	x			x		
	62. Outlays are for the purposes for which the appropriation was provided and in an amount not exceeding the obligation, as adjusted, authorizing the outlay (FAM 395F: 01f)						x
	63. Outlays do not use “first-in, first out” or other arbitrary means to liquidate obligations, unless supporting evidence demonstrates it reasonably represents the manner in which costs are incurred (FAM 395F: 01f)						x
Actual Offsetting Collections (discretionary and mandatory)	64. Collections and receipts authorized or required to be credited to an appropriation account but not received before the account is closed are deposited in the Treasury as a miscellaneous receipt (FAM 395F: 01k)						x
Distributed Offsetting Receipts	65. Recorded offsetting collections are available for obligation during the year and were recorded in the proper accounts (GAO-02-126G, p. 27)	x					
	66. Recorded receipts are valid and were recorded in the proper accounts (GAO-02-126G, p. 36)	x					
	67. All current year offsetting receipts are recorded (GAO-02-126G, p. 36)		x				
	68. All current year offsetting collections are recorded (FAM 395B:5)		x				
	69. All current year offsetting collections and/or receipts are recorded at the correct amounts (FAM 395B: 9)			x			
	70. The entity has the rights to the recorded offsetting collections and/or receipts (FAM 395B: 13)					x	
	71. Offsetting collections and/or receipts are appropriately summarized, classified and presented on the financial statement (FAM 395B: 15)				x		
*Components should review applicable sections of the GAO/PCIE FAM section 2010 Federal Accounting Checklist and 2020 Federal Reporting and Disclosure Checklists to ensure proper presentation and disclosures.							
FBWT	72. Recorded FBWT amounts exist as of a given date. (FAM 921C: 1a)	x					
Indirectly: Obligated and Unobligated Balances, Brought Forward, October 1, and End of Period	73. Financial events recorded in the general ledger FBWT accounts at a given date are supported by appropriate source documents and detailed records that are accurately summarized and reconciled to the account balance and are recorded in the proper period (FAM 921C: 1a and 1b)	x	x	x	x		
	74. FBWT reports submitted to Treasury for all funds and Disbursing Locations are supported by the entity's general ledger and are submitted to Treasury in a timely manner (FAM 921: 10)**	x	x	x	x		
	75. Reconciling items identified during the FBWT reconciliation process are researched and resolved in a timely manner (FAM 921:18)**	x	x	x		x	
	76. Transactions recorded in budget clearing and/or suspense accounts are researched and resolved/cleared in a timely manner (FAM 921: 18)**	x	x	x		x	

Statement of Budgetary Resources Wave 2 – SBR Audit Financial Reporting Objectives						
Line Items	Financial Reporting Objectives	Financial Statement Assertions				Compliance
		Existence	Completeness	Valuation	Presentation & Disclosure	Rights & Obligations
	77. Access to FBWT, critical forms, records, and processing and storage areas is in accordance with laws, regulations, and management policy – Persons do not have uncontrolled access to both assets and records; they are not assigned duties to put them in a position that would allow them to both commit and conceal errors or fraud (i.e., segregation of duties) (FAM 921C: 1c)		x			
	78. All FBWT balance amounts are included in the financial statements – and reconciles to activity/balances in monthly Treasury reports for the reporting period (FAM 921C: 2a)**		x			
	79. FBWT transactions are accurately recorded (FAM 921C: 3a)			x	x	
	80. FBWT is properly classified and described in the financial statements (FAM 921C: 6a)				x	
	81. FBWT is based on accounting principles that are applied consistently from period to period (FAM 921C: 7a)				x	
	82. The entity owns recorded FBWT – FBWT amounts represent legislative spending limits granted to the agency available for use during the current period (FAM 921C: 4a)					x
	83. The entity has the rights to recorded FBWT at a given date – FBWT balance is reflective of entities' budget authority at a given date (FAM 921C: 5a)					x
	84. All required disclosures are made and are accurately reported (FAM 921C: 8a)				x	
Note: Other Defense Organizations must take into account the additional complexities of shared appropriations. ** FRO related to the FBWT Reconciliation Process						

Assessable Unit Risks and Outcomes

For the most common Wave 2 assessable units throughout DoD, FIAR has defined baseline financial reporting risks and related outcomes. Specifically, FIAR has identified the key risks for these assessable units that may cause a financial statement balance to be inaccurate or invalid. Once the risks are mitigated the related assessable unit outcome is achieved. Figure 2 depicts how the tailored risks and outcomes relate to the Wave 2 risks of material misstatement and financial reporting objectives identified.



Figure 2. Relationship of Wave 2 Risks and Financial Reporting Objectives to Assessable Unit Financial Reporting Risks and related Outcomes

Financial Reporting Risks		FIAR Guidance Risk of Material Misstatement (ROMM) Reference	Outcomes Demonstrating Audit Readiness	FIAR Guide Financial Reporting Objective (FRO) Reference
Contract Pay				
1	All obligations may not be recorded timely	SBR Wave 2, ROMM #20	All obligations are recorded in the correct period and within 10 days of award	SBR Wave 2, FRO #33
2	Obligations may be recorded inaccurately or may be invalid	SBR Wave 2, ROMM #7, 8, 11, 12, 19, 34, 44	Obligations are recorded accurately (correct amount, Treasury account, vendor, line of accounting (agrees to requisition), reporting entity) and contracts are valid (authorized/approved transactions supported by contract)	SBR Wave 2, FRO #24, 25, 26, 30, 31, 32, 34, 35, 53, 54
3	All accruals and/or payables may not be recorded timely	SBR Wave 2, ROMM #21	All accruals and/or payables (for goods/services received not yet invoiced) are recorded in the correct period and within 10 days of receipt	SBR Wave 2, FRO # 41, 43
4	Accruals and/or payables may be recorded inaccurately or may be invalid	SBR Wave 2, ROMM #34	All accruals and/or payables are recorded accurately (correct amount, Treasury account, contract/obligation/line of accounting, reporting entity) and invoices are valid (authorized/approved transactions supported by evidence goods/services were received or otherwise due)	SBR Wave 2, FRO #37, 39, 40, 42, 43, 44, 53, 54
5	All disbursements may not be recorded timely	SBR Wave 2, ROMM #22	All disbursements are recorded in the correct period and within 10 days of payment	SBR Wave 2, FRO #57, 60
6	Disbursements may be recorded inaccurately or may be invalid	SBR Wave 2, ROMM #10, 36	Disbursements are recorded accurately (correct amount, Treasury account, contract/obligation/line of accounting, reporting entity) and disbursements are valid (authorized/approved transactions supported by invoice and receiving report)	SBR Wave 2, FRO #55, 56, 58, 59, 61
7	Stale or invalid obligations and accruals may not be removed	SBR Wave 2, ROMM #2, 9, 14, 27	All obligations and accruals are reviewed, and adjusted as necessary, at least three times per year	SBR Wave 2, FRO #11, 12, 22, 27, 43
8	IT General Controls may not be appropriately designed or operating effectively	FIAR Guidance FISCAM Risks	All material systems achieve the relevant FISCAM IT general and application-level general control objectives	FIAR Guidance FISCAM Objectives
MILSTRIP				
1	All obligations may not be recorded timely	SBR Wave 2, ROMM #20	All obligations are recorded in the correct period and within 10 days	SBR Wave 2, FRO #33
2	Obligations may be recorded inaccurately or may be invalid	SBR Wave 2, ROMM #7, 8, 11, 12, 19, 34, 44	Obligations are recorded accurately (correct amount, Treasury account, line of accounting, reporting entity) and are valid (authorized/approved transactions supported by requisition documentation)	SBR Wave 2, FRO #24, 25, 26, 30, 31, 32, 34, 35, 53, 54
3	All receipt/payables may not be recorded timely	SBR Wave 2, ROMM #21	All receipts/payables (for goods received not yet invoiced) are recorded in the correct period and within 10 days of receipt	SBR Wave 2, FRO # 41, 43
4	Receipt/Payables may be recorded inaccurately or may be invalid	SBR Wave 2, ROMM #34	All receipts/payables are recorded accurately (correct amount, line of accounting, obligation, Treasury account, reporting entity) and are valid (authorized/approved transactions supported by evidence goods were actually received)	SBR Wave 2, FRO #37, 39, 40, 42, 43, 44, 53, 54
5	All disbursements may not be recorded timely	SBR Wave 2, ROMM #22	All disbursements are recorded in the correct period and within 10 days of payment	SBR Wave 2, FRO #57, 60

Financial Reporting Risks		FIAR Guidance Risk of Material Misstatement (ROMM) Reference	Outcomes Demonstrating Audit Readiness	FIAR Guide Financial Reporting Objective (FRO) Reference
6	Disbursements may be recorded inaccurately or may be invalid	SBR Wave 2, ROMM #10, 36	Disbursements are recorded accurately (correct amount, line of accounting, obligation, Treasury account, reporting entity) and disbursements are valid (authorized/approved transactions supported by invoice and receiving report)	SBR Wave 2, FRO #55, 56, 58, 59, 61
7	Stale or invalid obligations and accruals may not be removed	SBR Wave 2, ROMM #2, 9, 14, 27	All obligations and accruals are reviewed, and adjusted as necessary, at least three times per year.	SBR Wave 2, FRO #11, 12, 22, 27, 43
8	IT General Controls may not be appropriately designed or operating effectively	FIAR Guidance FISCAM Risks	All material systems achieve the relevant FISCAM IT general and application-level general control objectives	FIAR Guidance FISCAM Objectives
Vendor Pay				
1	All obligations may not be recorded timely	SBR Wave 2, ROMM #20	All obligations are recorded in the correct period and within 10 days	SBR Wave 2, FRO #33
2	Obligations may be recorded inaccurately or may be invalid	SBR Wave 2, ROMM #7, 8, 11, 12, 19, 34, 44	Obligations are recorded accurately (correct amount, Treasury account, vendor, line of accounting, reporting entity) and are valid (authorized/approved transactions supported by obligation documentation)	SBR Wave 2, FRO #24, 25, 26, 30, 31, 32, 34, 35, 53, 54
3	All accruals and/or payables may not be recorded timely	SBR Wave 2, ROMM #21	All accruals and/or payables (for goods/services received not yet invoiced) are recorded in the correct period and within 10 days of receipt	SBR Wave 2, FRO # 41, 43
4	Accruals and/or payables may be recorded inaccurately or may be invalid	SBR Wave 2, ROMM #34	All accruals and/or payables are recorded accurately (correct amount, Treasury account, obligation/line of accounting, reporting entity) and invoices are valid (authorized/approved transactions supported by evidence goods/services were received or otherwise due)	SBR Wave 2, FRO #37, 39, 40, 42, 43, 44, 53, 54
5	All Disbursements may not be recorded timely	SBR Wave 2, ROMM #22	All disbursements are recorded in the correct period and within 10 days of payment	SBR Wave 2, FRO #57, 60
6	Disbursements may be recorded inaccurately or may be invalid	SBR Wave 2, ROMM #10, 36	Disbursements are recorded accurately (correct amount, Treasury account, obligation/line of accounting, reporting entity) and disbursements are valid (authorized/approved transactions supported by invoice and receiving report)	SBR Wave 2, FRO #55, 56, 58, 59, 61
7	Stale or invalid obligations and accruals may not be removed	SBR Wave 2, ROMM #2, 9, 14, 27	All obligations and accruals are reviewed, and adjusted as necessary, at least three times per year	SBR Wave 2, FRO #11, 12, 22, 27, 43
8	IT General Controls may not be appropriately designed or operating effectively	FIAR Guidance FISCAM Risks	All material systems achieve the relevant FISCAM IT general and application-level general control objectives	FIAR Guidance FISCAM Objectives
Reimbursable Work Order – Grantor				
1	All obligations may not be recorded timely	SBR Wave 2, ROMM #20	All obligations are recorded in the correct period and within 10 days	SBR Wave 2, FRO #33
2	Obligations may be recorded inaccurately or may be invalid	SBR Wave 2, ROMM #7, 8, 11, 12, 19, 34, 44	Obligations are recorded accurately (correct amount, Treasury account, line of accounting, reporting entity) and are valid (authorized/approved transactions supported by authorized documentation)	SBR Wave 2, FRO #24, 25, 26, 30, 31, 32, 34, 35, 53, 54
3	All accruals/payables may not be recorded timely	SBR Wave 2, ROMM #21	All receipts/payables (for goods/services received not yet invoiced) are recorded in the correct period and within 10 days of receipt	SBR Wave 2, FRO # 41, 43

Financial Reporting Risks		FIAR Guidance Risk of Material Misstatement (ROMM) Reference	Outcomes Demonstrating Audit Readiness	FIAR Guide Financial Reporting Objective (FRO) Reference
4	Accruals/payables may be recorded inaccurately or may be invalid	SBR Wave 2, ROMM #34	All receipts/payables are recorded accurately (correct amount, line of accounting, obligation, Treasury account, reporting entity) and are valid (authorized/approved transactions supported by evidence goods/services were actually received)	SBR Wave 2, FRO #37, 39, 40, 42, 43, 44, 53, 54
5	All IPAC disbursements/advances may not be recorded timely	SBR Wave 2, ROMM #22	All IPAC disbursements/Advances are recorded in the correct period and within 10 days of payment	SBR Wave 2, FRO #57, 60
6	IPAC Disbursements/advances may be recorded inaccurately or may be invalid	SBR Wave 2, ROMM #10, 36	IPAC Disbursements/Advances are recorded accurately (correct amount, line of accounting, obligation, Treasury account, reporting entity) and are valid (authorized/approved transactions supported by invoices/orders/receiving report)	SBR Wave 2, FRO #55, 56, 58, 59, 61
7	Stale or invalid obligations and accruals may not be removed	SBR Wave 2, ROMM #2, 9, 14, 27	All obligations and accruals are reviewed, and adjusted as necessary, at least three times per year	SBR Wave 2, FRO #11, 12, 22, 27, 43
8	IT General Controls may not be appropriately designed or operating effectively	FIAR Guidance FISCAM Risks	All material systems achieve the relevant FISCAM IT general and application-level general control objectives	FIAR Guidance FISCAM Objectives
Fund Balance with Treasury				
1	All disbursements and collections may not be reported timely	FBWT Wave 2, ROMM #4, 5	All disbursements and collections are reported to Treasury in the correct period and within Treasury deadline	SBR Wave 2, FRO # 73, 74, 77, 78
2	Disbursements and collections may not be reported accurately or be valid	FBWT Wave 2, ROMM # 1, 6, 8, 13, 26, 42	Disbursements and collections are accurately (correct amount, Treasury account, budget fiscal year) reported to Treasury and are valid (authorized/approved transactions supported by documentation, e.g. invoice and receiving report)	SBR Wave 2, FRO # 9, 10, 73, 74, 78, 79, 81
3	All Treasury accounts may not be reconciled timely	FBWT Wave 2, ROMM #2	All Treasury accounts related to the Component are reconciled monthly within required timeline	SBR Wave 2, FRO # 48, 77, 78
4	Reconciliations, including general ledger and disbursing system data, may not be accurate	FBWT Wave 2, ROMM #1, 6, 8, 10, 11	All Treasury reconciliations, including general ledger and disbursing system data, are accurate (using correct Treasury accounts, dollar amounts/ accounting periods from GWA, General Ledger, and Disbursing)	SBR Wave 2, FRO # 48, 72, 79, 81, 82, 83
5	All reconciling items may not be identified timely	FBWT Wave 2, ROMM #3, 4, 5	All reconciling differences and budget clearing account items are identified at the transaction level (specific disbursement or collection causing the difference)	SBR Wave 2, FRO # 75, 76
6	Reconciling items may not resolved accurately or be valid	FBWT Wave 2, ROMM # 1, 6	Reconciling and budget clearing account items are appropriately resolved (adjustment recorded in General Ledger or reported to Treasury (SF 1219/1220), at the correct amount (Treasury account and budget fiscal year) and valid (authorized/approved transactions supported by documentation that demonstrates how the individual transaction should have been recorded/reported)	SBR Wave 2, FRO # 75, 76
7	IT General Controls may not be appropriately designed or operating effectively	FIAR Guidance FISCAM Risks	All material systems achieve the relevant FISCAM IT general and application-level general control objectives	FIAR Guidance FISCAM Objectives

Financial Reporting Risks		FIAR Guidance Risk of Material Misstatement (ROMM) Reference	Outcomes Demonstrating Audit Readiness	FIAR Guide Financial Reporting Objective (FRO) Reference
Appropriations Received				
1	Apportionment amounts do not agree to the total appropriated amount	Appropriations Received Wave 1, ROMM #4, 9; SBR Wave 2, ROMM #29	Apportionments agree to total amount appropriated (dollar amount, Treasury account, type of funds, years of availability)	Appropriations Received Wave 1, FRO #1, 2, 3; SBR Wave 2 #45
2	Allotted amounts do not agree to appropriated/apportioned amounts	Appropriations Received Wave 1, ROMM #5; SBR Wave 2, ROMM #30	Allotted amounts agree to total amount apportioned/appropriated (dollar amount, Treasury account, type of funds, years of availability)	Appropriations Received Wave 1, FRO #4
3	Current year funds distributed may not be recorded timely in the Distribution System	Appropriations Received Wave 1, ROMM #2, 3; SBR Wave 2, ROMM #15, 28	All current year funds are recorded in Distribution System the correct period	Appropriations Received Wave 1, FRO #2
4	Current year funds distributed may be recorded inaccurately in the Distribution System or may be invalid	Appropriations Received Wave 1, ROMM #3; SBR Wave 2, ROMM #28	Current year funds are recorded accurately (correct amount, treasury account, type of funds, years of availability, reporting entity) and are valid (authorized/approved transactions supported by Funding Authorization Documents (FAD))	Appropriations Received Wave 1, FRO #1, 2, 3
5	Current year sub-allotments may not be recorded timely	Appropriations Received Wave 1, ROMM #2, 3; SBR Wave 2, ROMM #15, 28	Current year sub-allotments are recorded in the correct period	Appropriations Received Wave 1, FRO #2
6	Current year sub-allotments may be recorded inaccurately or may be invalid	Appropriations Received Wave 1, ROMM #3; SBR Wave 2, ROMM #28	Current year sub-allotments are recorded accurately (correct amount, Treasury account, type of funds, years of availability, reporting entity) and are valid (authorized/approved transactions supported by FAD)	Appropriations Received Wave 1, FRO #1, 2, 3
7	Current year funds distributed may not be recorded timely in the General Ledger	Appropriations Received Wave 1, ROMM #2, 3; SBR Wave 2, ROMM #15, 28	Current year funds are recorded in the general ledger in the correct period.	Appropriations Received Wave 1, FRO #2
8	Current year funds distributed may be recorded inaccurately in the General Ledger or may be invalid	Appropriations Received Wave 1, ROMM #3; SBR Wave 2, ROMM #28	Current year funds are recorded accurately (correct amount, Treasury account, type of funds, years of availability, reporting entity) and are valid (authorized/approved transactions supported by Funding Authorization Documents (FAD))	Appropriations Received Wave 1, FRO #1, 2, 3
9	Other activity (e.g. undistributed amounts) may be recorded inaccurately in the General Ledger that may affect the balance of current year fund distributed within the organization.	Appropriations Received Wave 1 #3; SBR Wave 2, ROMM #28	Other activity (e.g. undistributed amounts) that affect the balance of the current year funds distributed within the organization are recorded accurately (correct amount, Treasury account, type of funds, years of availability, reporting entity).	Appropriations Received Wave 1, FRO #2
10	IT General Controls may not be appropriately designed or operating effectively	FIAR Guidance FISCAM Risks	All material systems achieve the relevant FISCAM IT general and application-level general control objectives	FIAR Guidance FISCAM Objectives

Financial Reporting Risks		FIAR Guidance Risk of Material Misstatement (ROMM) Reference	Outcomes Demonstrating Audit Readiness	FIAR Guide Financial Reporting Objective (FRO) Reference
Military Pay				
1	Personnel information may not be recorded timely	SBR Wave 2, ROMM #19, 20, 21, 22	All personnel information (promotions, changes in dependents, entering/exiting theater, etc.) are recorded timely	SBR Wave 2, FRO #32, 33, 41, 43
2	Personnel information may be recorded inaccurately or may be invalid	SBR Wave 2, ROMM #7, 9, 22, 34, 36, 38, 39	Personnel information is recorded accurately (correct amount, correct action, correct individual) and are valid (authorized/approved transactions supported by request for personnel action)	SBR Wave 2, FRO #27, 34, 35, 37, 41, 42, 43, 44
3	Payroll may be calculated or processed inaccurately	SBR Wave 2, ROMM #7, 9, 22, 34, 36, 38, 39	Payroll is calculated and processed accurately	SBR Wave 2, FRO #27, 34, 35, 37, 41, 42, 43, 44
4	All payroll obligations, expenses, accruals, and disbursements may not be recorded timely	SBR Wave 2, ROMM #19, 20, 21, 22	All payroll obligations, expenses, accruals, and disbursements are recorded timely	SBR Wave 2, FRO #32, 33, 41, 43
5	Payroll obligations, expenses, accruals, and disbursements may not be recorded accurately or may be invalid	SBR Wave 2, ROMM #7, 9, 22, 34, 36, 38, 39	All payroll obligations, expenses, accruals, and disbursements are recorded at correct amounts in the General Ledger(s) and are valid entries (authorized/approved transactions supported by pay file, disbursing voucher, etc.)	SBR Wave 2, FRO #27, 34, 35, 37, 41, 42, 43, 44
6	Stale or invalid obligations and accruals may not be removed	SBR Wave 2, ROMM #2, 9, 14, 27	All obligations and accruals are reviewed, and adjusted as necessary, at least three times per year	SBR Wave 2, FRO #11, 12, 22, 27, 43
7	IT General Controls may not be appropriately designed or operating effectively	FIAR Guidance FISCAM Risks	All material systems achieve the relevant FISCAM IT general and application-level general control objectives	FIAR Guidance FISCAM Objectives
Civilian Pay				
1	Incorrect personnel information may be recorded	SBR Wave 2, ROMM #7, 34, 36	Civilian personnel actions are valid (authorized/approved transactions supported by requests for personnel action) and recorded accurately	SBR Wave 2, FRO #34, 37, 42
2	Personnel information is missing or incomplete	SBR Wave 2, ROMM #19, 20, 34	All civilian personnel actions are recorded timely	SBR Wave 2, FRO #32, 33, 34, 41, 42, 43
3	Incorrect time and attendance information may be recorded	SBR Wave 2, ROMM #34, 36	T&A information is valid (authorized/approved transactions supported by timesheet) and is recorded correctly	SBR Wave 2, FRO #34, 42
4	Time and attendance information is missing or incomplete	SBR Wave 2, ROMM #19	All T&A information is recorded timely	SBR Wave 2, FRO #32, 33, 41, 43
5	Payroll may be calculated or processed incorrectly	SBR Wave 2, ROMM #34, 36	Bi-weekly payroll is calculated and processed correctly	SBR Wave 2, FRO #42
6	Payroll obligations, expenses, accruals and disbursements may be recorded incorrectly	SBR Wave 2, ROMM #10, 34, 38, 39, 40	Payroll obligations, expenses, accruals, and disbursements are valid (authorized/approved transactions supported by pay file, disbursing voucher, etc.) and are correctly recorded in the General Ledger(s)	SBR Wave 2, FRO #35, 37, 42, 44

Financial Reporting Risks		FIAR Guidance Risk of Material Misstatement (ROMM) Reference	Outcomes Demonstrating Audit Readiness	FIAR Guide Financial Reporting Objective (FRO) Reference
7	All Payroll obligations, expenses, accruals and disbursements may not be recorded	SBR Wave 2, ROMM #22	All payroll obligations, expenses, accruals and disbursements are recorded in the General Ledger(s) timely	SBR Wave 2, FRO #41, 43
8	Stale obligations and accruals may not be removed	SBR Wave 2, ROMM #2, 9, 14, 27	All stale obligations and accruals are removed from the General Ledger(s) timely	SBR Wave 2, FRO #11, 12, 22, 27, 43
9	IT General Controls may not be appropriately designed or operating effectively	FIAR Guidance FISCAM Risks	All material systems achieve the relevant FISCAM IT general and application-level general control objectives	FIAR Guidance FISCAM Objectives
Reimbursable Work Orders - Acceptor				
1	All unfilled customer orders may not be recorded timely	SBR Wave 2, ROMM #16	All unfilled customer orders are recorded in the correct period and within 10 days	SBR Wave 2, FRO # 16, 17
2	Unfilled customer orders may be recorded inaccurately or may be invalid	SBR Wave 2, ROMM #4, 31, 34, 43	Unfilled customer orders are recorded accurately (correct amount, Treasury account, line of accounting, reporting entity) and are valid (authorized/approved transactions supported by MIPR)	SBR Wave 2, FRO # 13, 14, 16
3	All revenue, advances, IPA collections may not be recorded timely	SBR Wave 2, ROMM #23	All revenue/IPAC collections are recorded in the correct period and within 10 days of payment	SBR Wave 2, FRO #15, 67, 68
4	Revenue/advances/IPAC collections may be recorded inaccurately or may be invalid	SBR Wave 2, ROMM #10, 37, 41	Revenue/IPAC collections are recorded accurately (correct amount, line of accounting, obligation, Treasury account, reporting entity) and are valid (authorized/approved transactions supported by invoices/orders/receiving report)	SBR Wave 2, FRO #65, 66, 69, 70, 71
5	Stale or invalid unfilled customer orders and uncollected customer payments/accounts receivable may not be removed	SBR Wave 2, ROMM #37	All unfilled customer orders and uncollected customer payments/accounts receivable are reviewed, and adjusted as necessary, at least three times per year	SBR Wave 2, FRO #66
6	IT General Controls may not be appropriately designed or operating effectively	FIAR Guidance FISCAM Risks	All material systems achieve the relevant FISCAM IT general and application-level general control objectives	FIAR Guidance FISCAM Objectives
Other Budgetary Activity				
1	All other budgetary activity (rescissions, non-expenditure transfers) may not be recorded timely	SBR Wave 2, ROMM #17, 18	All other budgetary activity is reported in the correct period.	SBR Wave 2, FRO #19, 21, 46
2	Other budgetary activity (rescissions, non-expenditure transfers) may be recorded inaccurately or may be invalid	SBR Wave 2, ROMM #5, 6, 32, 33, 38, 41	Other budgetary activity is recorded accurately (dollar amount, Treasury account, type of funds, years of availability) and valid (authorized/approved transaction supported by Public Law, Treasury Warrant, SF-1151s, FADs)	SBR Wave 2, FRO #18, 19, 20, 47, 50, 51
3	All current year other budgetary activity sub- allotments may not be recorded timely	SBR Wave 2, ROMM #17, 18	All current year other budgetary activity for sub-allotments is recorded in the correct period.	SBR Wave 2, FRO #19, 21, 46

Financial Reporting Risks		FIAR Guidance Risk of Material Misstatement (ROMM) Reference	Outcomes Demonstrating Audit Readiness	FIAR Guide Financial Reporting Objective (FRO) Reference
4	Current year other budgetary activity sub- allotments may be recorded inaccurately or may be invalid	SBR Wave 2, ROMM #5, 32, 33, 38, 41	Current year other budgetary activity for sub-allotments are recorded accurately (correct amount, Treasury account, type of funds, years of availability, reporting entity) and are valid (authorized/approved transactions supported by FAD)	SBR Wave 2, FRO #18, 19, 20, 47, 50, 51
5	IT General Controls may not be appropriately designed or operating effectively	FIAR Guidance FISCAM Risks	All material systems achieve the relevant FISCAM IT general and application-level general control objectives	FIAR Guidance FISCAM Objectives
Financial Reporting				
1	All trial balances (or equivalents) are not produced timely	SBR Wave 2, ROMM #25, 40	Trial balances (or equivalents) are produced timely	SBR Wave 2, FRO #3, 8
2	Trial balances (or equivalents) are not accurate or valid	SBR Wave 2, ROMM #11, 12, 24, 38, 39	Trial balances (or equivalents) are accurate and valid	SBR Wave 2, FRO #1, 2, 4, 5, 6, 7
3	All trial balances (or equivalents) are not loaded into DDRS-B timely	SBR Wave 2, ROMM #25, 40	Trial balances (or equivalents) are loaded into DDRS-B timely	SBR Wave 2, FRO #3, 8
4	Trial balances (or equivalents) are not completely or accurately loaded into DDRS-B	SBR Wave 2, ROMM #11, 12, 24, 38, 39	Trial balances (or equivalents) are complete and accurately loaded into DDRS-B	SBR Wave 2, FRO #1, 2, 4, 5, 6, 7
5	All trial balance data in DDRS-B is not loaded into DDRS-AFS	SBR Wave 2, ROMM #25, 40	Trial balance data in DDRS-B is loaded into DDRS-AFS timely	SBR Wave 2, FRO #3, 8
6	Trial balance data is not accurately loaded from DDRS-B into DDRS-AFS	SBR Wave 2, ROMM #11, 12, 24, 38, 39	Trial balances data is accurately loaded from DDRS-B into DDRS-AFS	SBR Wave 2, FRO #1, 2, 4, 5, 6, 7
7	All adjustments recorded in DDRS-B and DDRS-AFS are recorded timely	SBR Wave 2, ROMM #25, 40	All adjustments are recorded timely in DDRS-B and DDRS-AFS	SBR Wave 2, FRO #3, 8
8	Adjustments recorded in DDRS-B and DDRS-AFS are not accurate or valid	SBR Wave 2, ROMM #11, 12, 24, 38, 39	All adjustments recorded in DDRS-B and DDRS-AFS are accurate (correct amount, Treasury account, line of accounting, reporting entity) and valid (authorized/approved transactions supported by appropriate documentation)	SBR Wave 2, FRO #1, 2, 4, 5, 6, 7
9	The Statement of Budgetary Resources, related footnotes and accompanying information is not completed timely	SBR Wave 2, ROMM #25, 40	The Statement of Budgetary Resources, related footnotes and accompanying information is completed timely.	SBR Wave 2, FRO #3, 8
10	The Statement of Budgetary Resources, related footnotes and accompanying information is not accurate or valid	Appropriations Received Wave 1, ROMM #8; SBR Wave 2, ROMM #38, 39, 40; FBWT Wave 2, ROMM #7, 9	The Statement of Budgetary Resources, related footnotes and accompanying information is accurate (complies with accounting and reporting standards) and valid (supported by data in DDRS-AFS)	SBR Wave 2, FRO #1, 2, 3, 80, 84

Financial Reporting Risks		FIAR Guidance Risk of Material Misstatement (ROMM) Reference	Outcomes Demonstrating Audit Readiness	FIAR Guide Financial Reporting Objective (FRO) Reference
11	IT General Controls may not be appropriately designed or operating effectively	FIAR Guidance FISCAM Risks	All material systems achieve the relevant FISCAM IT general and application-level general control objectives	FIAR Guidance FISCAM Objectives

Key Supporting Documents

The following table lists the minimum internal control documentation and supporting documentation necessary to support activity and balances asserted as audit-ready for an SBR Audit. The table links each listed document to the potential financial statement assertions that it supports. Internal control documentation is marked as meeting all financial statement assertions, because the specific control activities described in the internal control documentation will determine which specific financial statement assertions are satisfied.

Statement of Budgetary Resources Wave 2 – SBR Audit Key Supporting Documents							
Line Items	Documentation Type	Key Supporting Documents	Financial Statement Assertions				
			Existence	Completeness	Valuation	Presentation & Disclosure	Rights & Obligations
All Financial Statement Line Items	Internal Control	1. Statement-to-process analyses demonstrating the dollar amount and quantity of activity flowing through various processes and/or locations	x	x	x	x	x
		2. Applicable policies and procedures	x	x	x	x	x
		3. Process narratives and flowcharts	x	x	x	x	x
		4. Control worksheets, identifying risks, FROs and corresponding control activities	x	x	x	x	x
		5. Test plans documenting planned procedures used to test the operating effectiveness of control activities	x	x	x	x	x
		6. Control assessments with test results	x	x	x	x	x
		7. Evaluation of test results	x	x	x	x	x
		8. Documentation demonstrating the operation of internal control activities for the period under audit. Examples include: <ul style="list-style-type: none">Approval signature documentation (electronic or manual) demonstrating accuracy reviews of appropriation transactions recorded in the general ledger (compared to supporting documentation such as Appropriation Act / Public Law)Reconciliations of non-expenditure transfers recorded in the general ledger to OMB-approved Non-Expenditure Transfer Authorizations (SF-1151s)	x	x	x	x	x
		9. System inventory list, listing of system users and their access privileges.	x	x	x	x	x

Statement of Budgetary Resources Wave 2 – SBR Audit Key Supporting Documents								
Line Items	Documentation Type	Key Supporting Documents	Financial Statement Assertions					
			Existence	Completeness	Valuation	Presentation & Disclosure	Rights & Obligations	
All Financial Statement Line Items (especially Unobligated Balances: Apportioned, and Unobligated Balances Not Available)	Transaction Documentation	10. Apportionment and Reapportionment Schedule (SF 132)	x	x	x	x	x	
		11. Report on Budget Execution and Budgetary Resources (SF 133)	x	x	x	x	x	
		12. Year-End Closing Statement (FMS 2108)	x	x	x	x	x	
		13. Trial balance by fund code (Treasury account) corresponding to each appropriation	x	x	x	x	x	
		14. Reconciliation of populations to general ledger and to the financial statements. Including the reconciliation of unadjusted trial balances to adjusted trial balances and support for journal vouchers posted to the adjusted trial balance.		x		x		
Unobligated Balance,		15. FIRST-TIME AUDITS ONLY – Analysis of unobligated balance brought forward that demonstrates the “age” of material appropriations	x	x	x	x	x	
Brought Forward, October 1		16. FIRST-TIME AUDITS ONLY – Supporting documentation evidencing the beginning balances of Fund Balance with Treasury, Accounts Receivable, Unfilled Customer Orders, and Delivered Orders – Unpaid		x	x	x		
Recoveries of Prior Year Unpaid Obligations		17. Original obligating documents (such as contracts, reimbursable agreements, MIPRs, purchase orders, travel orders, grant agreements, etc.) along with contract modification documents supporting the recovery	x	x	x		x	
		18. Invoice/receiving report noting changes in payment amount (e.g., De-obligation of funds can result from receipt of goods or services with an invoice payment less than the obligation balance and no further activity is anticipated)	x	x	x		x	
Spending Authority from Offsetting Collections		19. Documentation demonstrating spending authority and collections from other Federal agencies such as Reimbursable Agreements, MIPRs, Intra-governmental Payment and Collection (IPACs), billing documents and related supporting documentation	x	x	x		x	
		20. Documentation supporting amounts earned (invoices to customer agency, obligating document/receiving reports/invoices from vendor performing services, payroll (timesheets, official personnel files, etc.) for internal payroll charges, travel orders/vouchers, etc.)		x	x		x	
		21. Cash collection documentation (for amounts earned and advances received) such as deposit tickets, IPACs, etc.	x	x	x			
Nonexpenditure Transfers, net		22. Non-expenditure Transfer Authorization (SF 1151)	x	x	x		x	
		23. Appropriation Act (Public Law) enacting temporary restrictions on budgetary resources or permanent rescission	x	x	x		x	
Obligations Incurred: Direct and Reimbursable		24. Negative Treasury Warrants (Rescission)	x	x	x		x	
		25. Obligating document and related modifications such as contract purchase order, MIPR, etc. Note: for payroll transactions SF-52s (Request for Personnel Action), SF-50s (Notifications of Personnel Action), timesheets used to support disbursement transactions also support payroll obligations incurred.	x	x	x		x	
Unpaid Obligations, Brought Forward, October 1		26. Unpaid Obligations (Undelivered Orders) brought forward and at end of period are supported by valid obligating documents such as contracts, reimbursable agreements, MIPRs, purchase orders, etc. (first-year audits only). For any portions of the order delivered, see supporting documentation requirements for Delivered Orders	x	x	x		x	

Statement of Budgetary Resources Wave 2 – SBR Audit Key Supporting Documents							
Line Items	Documentation Type	Key Supporting Documents	Financial Statement Assertions				
			Existence	Completeness	Valuation	Presentation & Disclosure	Rights & Obligations
Unpaid Obligations, End of Period		Unpaid Obligations (Delivered Orders/Accounts Payable) brought forward and at end of period are supported by: 27. Receiving Report, and 28. Billing document such as vendor invoice (or equivalent), or 29. Accrual estimate support (if invoice has not been received or support for payroll accrual calculations)	x	x	x		x
Unfilled Customer Payments, Brought Forward, October 1		30. Uncollected Customer Payments (Unfilled Customer Orders) brought forward and at end of period are supported by valid orders from other Federal agencies such as Reimbursable Agreements	x	x	x		x
Unpaid Customer Payments, End of Period		31. Uncollected Customer Payments (Accounts Receivable) brought forward and at end of period are supported by subsequent IPAC collection documents	x	x	x		x
Gross Outlays		32. Cash disbursement document (invoice, receiving report, , IPAC, travel voucher, credit card statements, etc). Note: for payroll transactions SF-52s (Request for Personnel Action), SF-50s (Notifications of Personnel Action), timesheets used to support obligations incurred transactions also support payroll disbursements.	x	x	x		x
Offsetting Collections							
Distributed Offsetting Receipts		33. Cash collection document (deposit ticket, IPAC, billing document, etc)	x	x	x		x
		34. Statement of Accountability (SF 1218/1219)	x	x	x		x
		35. Statement of Transactions (SF 1220/1221)	x	x	x		x
		36. Statement of Interfund Transactions (DD 1400)	x	x	x		x
		37. Statement of Transactions (DD 1329)	x	x	x		x
		38. Government-wide Accounting (GWA) Account Statement	x	x	x		x
		39. Treasury Annual Report Appendix Part 7, Other Information B Receipts by Department	x	x			x
		40. Cash collection document (deposit ticket, IPAC, billing document, etc, to support basis for receipt)	x	x	x		x
Refer to the MilPay FIAR guidance supplement located within the FIAR Guidance website for KSDs related to Military Pay.							

Statement of Budgetary Resources Wave 2 – SBR Audit Key Supporting Documents							
Line Items	Documentation Types	Key Supporting Documents	Financial Statement Assertions				
			Existence	Completeness	Valuation	Presentation & Disclosure	Rights & Obligations
FBWT	Internal Control Documentation	41. Statement-to-process analyses demonstrating the dollar amount and quantity of activity flowing through various processes and/or locations	x	x	x	x	x
		42. Applicable policies and procedures	x	x	x	x	x
		43. Process narratives and flowcharts	x	x	x	x	x
		44. Control worksheets, identifying risks, FROs and corresponding control activities	x	x	x	x	x
		45. Test plans documenting planned procedures used to test the operating effectiveness of control activities	x	x	x	x	x
		46. Control assessments with test results	x	x	x	x	x
		47. Evaluation of test results	x	x	x	x	x
		48. Documentation evidencing the operation of internal control activities for the period under audit. Examples include: <ul style="list-style-type: none">A supervisory review is performed monthly to verify monthly Treasury reconciliations were performed timely and signed/dated by the completer, supervisor evidences review by signing and dating reconciliation.All reconciling items are aged monthly to ensure all differences are resolved within 60 days. Supervisor randomly selects items cleared from the aging and reviews supporting documentation (and entry recorded in system) to verify reconciling item was appropriately resolved.	x	x	x	x	x
	Transaction Documentation	49. Monthly FBWT reconciliations	x	x	x	x	x
		50. General ledger and subsidiary ledgers identifying individual FBWT transactions within each Treasury account	x			x	
		51. Supporting documentation for individual transaction differences and adjustments between the agency and Treasury's records, including supporting documentation for cash disbursements, cash collections and adjustments as described in the preceding sections.	x	x	x		x
		52. Check Issue Discrepancy (FMS 5206)	x	x	x		

C.2.3 Example Work Products

Refer to the FIAR Guidance website for [Wave 2 specific work product examples](#) and related guidance.

C.2.4 Wave-Specific Audit Execution

Wave 2 includes multiple end-to-end business processes and related financial statement line items that reporting entities can divide into assessable units. Reporting entities will assert audit readiness on individual assessable units once they determine that control activities are properly designed and operating effectively, and sufficient, accurate and relevant supporting documentation is readily available for examination. **Reporting entities must prepare and submit assertion documentation (i.e., risk assessments, control assessments, process narratives, test plans, etc.) to the FIAR Directorate as they complete the key tasks and activities in the Discovery and Corrective Action Phases. The FIAR Directorate will review the assertion documentation and provide feedback to the reporting entities on an ongoing basis. Once a reporting entity asserts that it is ready to undergo an examination of its Wave 2 assessable unit(s) by an IPA or the DoD OIG, the FIAR Directorate will validate that all key audit readiness dealbreakers (i.e., reconciled population, sufficient testing of control activities, etc.) have been sufficiently addressed. The FIAR Directorate will then engage an IPA or the DoD OIG to perform an examination on the assessable unit's audit readiness assertion during the Assertion/Evaluation phase. If the examination results in an unqualified opinion on the reporting entity's audit readiness assertion, the reporting entity must sustain their audit-ready state until they are ready for a full SBR audit. As depicted in Figure 3, reporting entities can only assert full SBR audit readiness after all assessable units are validated as audit ready through an independent examination. Once all Wave 2 assessable units are validated as audit ready, an IPA or the DoD OIG will perform annual financial statement audits on the reporting entity's SBR.**

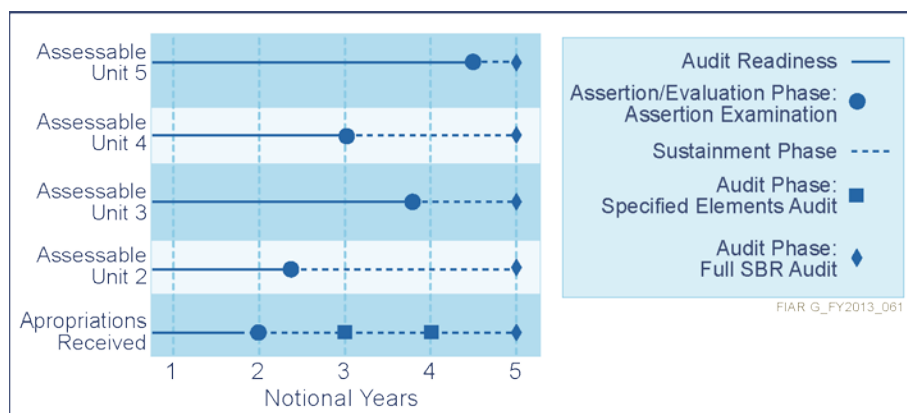


Figure 3. Wave 2 Audit Strategy

C.3 WAVE 3 – MISSION CRITICAL ASSET E&C AUDIT

Mission Critical Asset Existence and Completeness (E&C) Audits focus on the E&C financial statement assertions, but also include the Rights assertion and portions of the Presentation and Disclosure assertion. That is, **reporting entities must ensure that all assets recorded in their Accountable Property System of Record (APSR) exist (Existence), all of the reporting entities' assets are recorded in their APSR (Completeness), reporting entities have the right to report all assets (Rights), and assets are consistently categorized, summarized and reported period to period (Presentation and Disclosure). The asset categories include Military Equipment (ME), Real Property (RP), Inventory, Operating Materials and Supplies (OM&S), and General Equipment (GE).** This wave will allow the Department and its reporting entities to demonstrate the existence and completeness of its assets prior to focusing on the reported value of the assets.

C.3.1 Readiness Scope

Successful execution of the Department's military missions depends on a properly equipped and supplied Force. Achieving accurate and reliable accountable systems of record through E&C audits is the objective of Wave 3 and is a critical step for achieving successful financial statement audits.

Mission critical assets consist of accountable property. In other words, mission critical assets are not simply assets that exceed the capitalization threshold (Refer to DoD FMR Volume 4, Chapter 6, Section 060103.A.1.d for capitalization threshold) but are all assets greater than the property accountability threshold (Refer to DoDI 4165.14 para 5.1 for RP accountability threshold, DoDI 5000.64, para 6.2.1 for GE accountability threshold, and DoD 4140.1 for Inventory and OM&S accountability thresholds). Mission critical assets are defined broadly as: ME, RP (Land, Buildings, Structures and Facilities, and Construction in Progress), GE, Inventory, and OM&S.

As of September 30, 2010, these five asset categories comprise over 99 percent of the Department's total reported acquisition costs or amounts for PP&E and Inventory/OM&S. The OUSD(C) will periodically re-evaluate this coverage and will separately communicate with reporting entities if changes in scope are required.

The Department will demonstrate progress towards audit readiness when independent auditors render unqualified opinions on the existence and completeness of mission critical assets. To ensure success, it is important for both the reporting entity and auditor to understand the audit scope. These audits are to, determine whether (1) all the assets the reporting entity lists in its APSR exist and (2) the reporting entity reports all of its assets. However, to ensure compliance with auditing standards, auditors are also required to consider the impact of additional, interrelated areas, as Figure 4 demonstrates.

Auditors performing government financial statement audits in the United States must adhere to professional standards promulgated by Government Accountability Office (GAO) and the American Institute of Certified Public Accountants (AICPA) Auditing Standards Board. The GAO has codified its standards for financial statement and performance audits in the Government Auditing Standards (Yellow Book). The AICPA has codified its professional standards as AUs, which are incorporated by reference into the Government Auditing Standards. These professional standards require that the auditor be satisfied that elements, accounts, or items that are interrelated with those on which he or she has been engaged to express an opinion have been considered in expressing an opinion.

The GAO/PCIE FAM Section 235.02, “Identify Significant Line Items, Accounts, Assertions, and RSSI,” defines the Existence or Occurrence assertions as “Recorded transactions and accounting events have occurred during the given period, are properly classified, and **pertain to the entity**. An entity’s assets, liabilities, and net position exist at a given date.” The bolded text (which is the essence of the definition of the Rights assertion) demonstrates the interrelationship of the Rights and Existence assertions.

Presentation and Disclosure is the other assertion that is interrelated with E&C audits. Specifically, the summarization and classification elements of Presentation and Disclosure are directly related to E&C audits, because these are the assertions that ensure accurate quantities of assets are presented and correctly classified (e.g., assets reported as ME versus GE) on summary schedules covered by E&C audits.

Because of the interrelationship among the E&C and Rights assertions, along with elements of the Presentation and Disclosure assertion, it is necessary to include these assertions in the scope of E&C audit readiness preparation and resulting E&C audits, as shown in **Figure 4**.

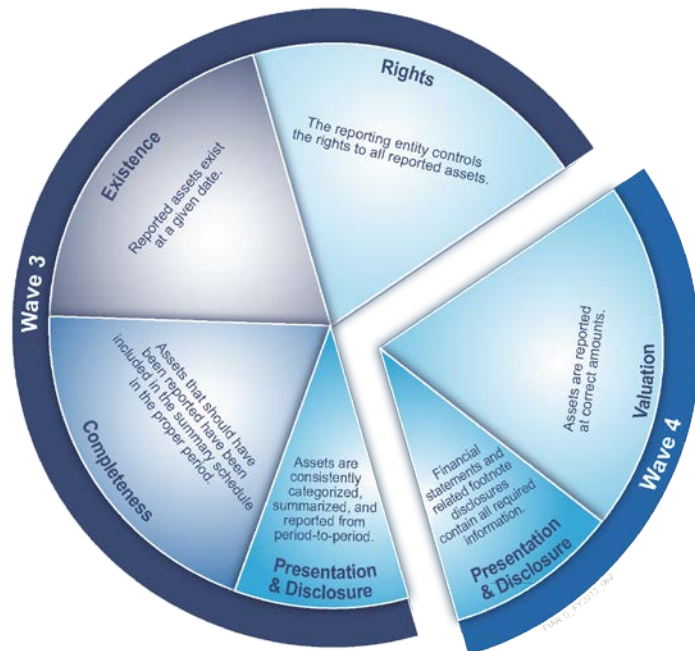


Figure 4. Audit scope of Wave 3, Existence and Completeness of Mission Critical Assets

Mission Critical Financial Management Data

The Department will have the auditors test financial management data maintained in the reporting entity’s APSR. This testing is in addition to the auditors determining whether assets recorded in the APSR physically exist and determining if the population of assets in the APSR is complete, i.e., includes all assets to which the reporting entity has rights that meet the property accountability threshold.

For a full listing of the financial management data that must be included in the scope of an E&C audit, see Section C.3.2, Subsection Financial Management Data. Ensuring that this information is accurate and reliable is important not only for managing mission critical assets, but also for proper financial reporting and future financial statement audits. For example, “Placed-in- Service Date” is important to ensure the completeness of asset records at the end of a reporting period.

Note Regarding Internal Controls:

When determining the scope of audit readiness efforts for Wave 3, reporting entities must consider whether it is more efficient to mostly use a substantive, supporting documentation approach (given the nature/size of the population). There will be instances when an entity and OUSD(C) conclude it is more efficient and effective to use a substantive approach to supporting an E&C audit-readiness assertion for specific assessable units (combined with a periodic physical inventory count control activity). For example, a reporting entity has a space satellites assessable unit with eight asset items and can substantively demonstrate the existence/completeness/rights to all eight assets even though the entity has not completed the process and internal control documentation (or without controls fully functioning). In this example, audit readiness may be asserted without completing extensive process and internal control documentation, in addition to the periodic physical inventory count.

However, it may not be practical for the auditor to rely on substantive testing, and instead the auditor needs to evaluate, test and place reliance on a reporting entity’s relevant internal control activities. For example, if a reporting entity has large quantities of OM&S that are geographically dispersed with a high volume of acquisition and/or disposal activity, it may not be practical for an auditor to substantively test sufficient OM&S to render an opinion (since the OM&S balance is constantly changing). However, if the

auditors determine they can rely on the design and operating effectiveness of the reporting entity's control activities over the OM&S balance, the auditor can significantly reduce testing and rely on the control activities. The result is a significant reduction in the quantity of testing and duration of the E&C audit and result in direct cost and effort savings by both the reporting entity and its auditor.

Therefore, flexibility is needed with respect to process and controls documentation for E&C audits. When practical, a primarily substantive evidence approach can be used, but depending on the nature and quantities of assets and the potential need to remediate processes and control activities for new acquisitions, reporting entities may need to plan for complete process and internal control evaluations and documentation. The distinction will largely depend on the complexity of the business area and the quantity of assets and financial events. The following table identifies the major processes that are likely to affect the E&C of assets and potential segments of those processes that the entity should be consider.

Major Processes	Segments
Acquisitions (purchases, in-house construction, takings, transfers-in)	Key processes and internal controls that ensure the existence, completeness, and rights of assets should be included in an E&C assertion. These include: (a) controls to ensure all asset acquisitions (capital and accountable) are appropriately flagged or fed into asset/accountability/inventory systems; (b) controls to ensure assets are recorded when control of the asset passes to the reporting entity or when placed into service (for constructed assets); and (c) controls to ensure only assets to which the reporting entity has financial reporting responsibility (the reporting entity has the ability to control the benefits of the asset) are recorded.
Disposals (sales, destructions, donations, excesses, transfers- out)	Key processes and internal controls that ensure all disposals are correctly recorded in the APSR and disposals are only recorded when the reporting entity has transferred or otherwise ended its ability to control the asset.
Periodic physical inventory counts	Entire process is "in scope" and the principle control to ensure E&C.
APSR maintenance (IT general and application level controls surrounding the APSR)	Entire process is "in scope" and relevant to ensure information in the system of record is not incorrectly adjusted (especially subsequent to physical inventory counts) and that unauthorized personnel cannot make adjustments. For situations where supporting documentation is generated and/or retained electronically (e.g., transaction history within a system), then it is likely that system must also be scoped into audit readiness efforts.

C.3.2 Risks, Financial Reporting Objectives and Key Supporting Documents

Risks

The following table presents the key ROMM related to the Wave 3, Mission Critical Assets E&C Audit. A reference to the source of each risk is included in parentheses. **Reporting entities must mitigate these risks by designing and implementing control activities.** Refer to the FROs in the table following this risk table for further details.

Wave 3 – Mission Critical Asset E&C Audit Key Risks of Material Misstatement	
Financial Statement Assertions	Key Risks of Material Misstatement
Existence	<ol style="list-style-type: none"> Recorded transactions do not represent economic events that actually occurred. (FAM 395B: 1) Assets are not properly classified. (FAM 395B: 1c and 5) Recorded assets do not exist at a given date (FAM 395B: 4) Recorded assets may not be properly supported with adequate supporting documentation (FAM 395B: 4) Transactions are recorded in the current period, but the related economic events occurred in a different period (FAM 395B: 2) Transactions are summarized improperly, resulting in an overstated total (FAM 395B: 3)
Completeness	<ol style="list-style-type: none"> Assets of the reporting entity exist but are omitted from the APSR and/or summary schedules (financial statement equivalent) (FAM 395B: 8) Economic events occurred in the current period, but the related transactions are recorded in a different period (FAM 395B: 6) Transactions are summarized improperly, resulting in an understated total (FAM 395B: 7)
Presentation and Disclosure	<ol style="list-style-type: none"> Accumulated accounts or assets are not properly classified and described in the summary schedules (FAM 395B: 15) The current period summary schedules (various classes of assets) are based on accounting principles different from those used in prior periods presented (FAM 395B: 16) The entity is exposed to loss of assets and various potential misstatements, including certain of those above, as a result of inadequate segregation of duties (FAM 395B: 18)
Rights and Obligations	<ol style="list-style-type: none"> Recorded assets are owned* by others because of sale, consignment, or other contractual arrangements (FAM 395B: 12) The reporting entity does not have certain rights to recorded assets because of liens, pledges, or other restrictions (FAM 395B: 13) <p>* Note: OUSD(C) A&FP is currently updating the DoD FMR to clarify rights and reporting responsibilities for mission critical assets.</p>

Financial Reporting Objectives

Reporting entities must identify and implement a combination of control activities and supporting documentation to demonstrate that the FROs, relevant to the subject matter, assertion, or processes, (e.g., contract pay) have been achieved. Each FRO has been linked to its relevant financial statement assertions (as indicated with an “X” in the relevant columns), including if the FRO relates to compliance with laws and regulations. At the end of each FRO is a source reference. This is not a complete listing of control objectives, but rather those FROs needed to address key risk areas most likely to be present based on the Department's experience. Reporting entities must apply judgment to determine if additional FROs should be included given their specific business processes and financial statements. Reporting entities may also refer to the GAO/PCIE FAM Section 395B for a list of general control objectives based on financial statement assertions.

Wave 3 – Mission Critical Asset E&C Audit Financial Reporting Objectives						
Assets Categories	Financial Reporting Objectives	Financial Statement Assertions				
		Existence	Completeness	Valuation	Presentation & Disclosure	Rights & Obligations
Military Equipment	1. Accounts and all the transactions (or assets) they accumulate are properly classified and Accounting principles are consistently applied from period to period (FAM 395B: 15, 16).		x		x	
Real Property	2. Ensure recorded transactions represent economic events that actually occurred and are properly classified (FAM 395B: 1c, 2).	x				
Inventory	3. Ensure recorded assets exist at a given date (FAM 395B: 4a).	x				
Operating Materials and Supplies	4. Ensure recorded assets at a given date, are supported by appropriate detailed records that are accurately summarized and reconciled to the account balance (FAM 395B: 4b).	x				
General Property	5. Ensure recorded assets are owned by the entity. The entity has rights to the recorded asset at a given date (FAM 395B: 12, 13).					x
	6. Ensure all existing assets, as of the reporting date, including property in the custody of third parties, are included in the general ledger (FAM 395B: 8).		x			
	7. Asset transactions recorded in the current period represent economic events that occurred during the current period (FAM 395B: 2)	x				
	8. The summarization of recorded assets is not overstated (FAM 395B: 3)	x				
	9. All asset related events that occurred in the current period are recorded as transactions in the current period (FAM 395B: 6)		x			
	10. The summarization of recorded assets is not understated (FAM 395B: 7)		x			

Assessable Unit Risks and Outcomes

FIAR has defined baseline financial reporting risks and related outcomes related to Wave 3, Mission Critical Assets E&C. Specifically, FIAR has identified the key risks for Mission Critical Assets E&C that may cause a financial statement balance to be incomplete. Once these risks are mitigated Assets E&C FROs are achieved.

Financial Reporting Risks		FIAR Guidance Risk of Material Misstatement (ROMM) Reference	Outcomes Demonstrating Audit Readiness	FIAR Guide Financial Reporting Objective (FRO) Reference
Property, Plant and Equipment (PP&E)				
1	PP&E transactions may not be recorded	SBR Wave 3, ROMM #7, 8, 9	All PP&E transactions are recorded (physical inventory reconciles to ASPR records) and properly classified (individual item identifier, Asset Type, Controlling Organization) within the Accountable Property System of Record.	SBR Wave 3, KFRO # 1, 6, 9, 10

Financial Reporting Risks		FIAR Guidance Risk of Material Misstatement (ROMM) Reference	Outcomes Demonstrating Audit Readiness	FIAR Guide Financial Reporting Objective (FRO) Reference
2	Physical inventories are not conducted to verify existence of PP&E	SBR Wave 3, ROMM #1, 2, 3, 4, 5, 6, 13, 14	Physical inventories are conducted to validate the existence (ASPR records reconcile to physical inventory) of PP&E.	SBR Wave 3, KFRO # 2, 3, 4, 7, 8
3	Recorded PP&E transactions do not pertain to the entity	SBR Wave 3, ROMM #13, 14	Physical inventories are conducted to validate the PP&E transactions recorded in the ASPR pertain to the entity (asset tag with identification number pertaining to entity, asset marked with reporting entities name).	SBR Wave 3, KFRO # 5
4	PP&E transactions are not consistently categorized, summarized or reported from period to period.	SBR Wave 3, ROMM # 10, 11, 12	All PP&E transaction are consistently categorized (asset type properly recorded in ASPR), summarized or reported from period to period (summary schedule of assets from ASPR reconcile to the general ledger)	SBR Wave 3, KFRO # 1
5	IT General Controls may not be appropriately designed or operating effectively	FIAR Guidance FISCAM Risks	All material systems achieve the relevant FISCAM IT general and application-level general control objectives	FIAR Guidance FISCAM Objectives

Key Supporting Documents

Two types of documentation are needed to prepare for E&C audits. The first type of documentation, direct supporting documentation, includes internal control documentation and substantive, supporting documentation used by a reporting entity to directly demonstrate financial statement assertions (e.g., a land deed directly supports the Rights assertion). The second type of documentation, financial management data, represents supported data fields in the APSRs that substantiate financial reporting assertions and management/budget information (e.g., a tract map supports location information, which indirectly supports the Existence assertion). **Both types of documentation are required to demonstrate to management and decision makers the accuracy and reliability of E&C information.** Because supporting management with better information is the goal of the E&C audits, both categories of information are included in the scope of E&C audit readiness and therefore will be validated by auditors.

The following table presents a detailed listing by relevant financial statement assertion of minimum internal control and direct supporting documentation that a reporting entity must make readily available for auditors. For some financial statement assertions different levels or Tiers of documentation exist, which reporting entities may use to demonstrate financial statement assertions. In accordance with auditing standards, the most robust documentation, presented as Tier 1, should be used whenever possible. When Tier 1 documentation is unavailable, reporting entities should move down to Tier 2. **Please note that this list is not all-inclusive.** Additional documentation, including reporting entity-specific documentation, may exist that is equivalent to or supplements the items detailed in the table.

Line Items	Documentation Type	Wave 3 – Mission Critical Asset E&C Audit Key Supporting Documents	Financial Statement Assertions				
			Existence	Completeness	Valuation	Presentation & Disclosure	Rights & Obligations
All Financial Statement Line Items	Internal Control Documentation	1. Statement-to-process analyses demonstrating the dollar amount and quantity of activity flowing through various processes and/or locations	x	x		x	x
		2. Applicable policies and procedures	x	x		x	x
		3. Process narratives and flowcharts	x	x		x	x
		4. Control worksheets, identifying risks, FROs and corresponding control activities	x	x		x	x
		5. Test plans documenting planned procedures used to test the operating effectiveness of control activities	x	x		x	x
		6. Control assessments with test results	x	x		x	x
		7. Evaluation of test results	x	x		x	x
		8. Documentation demonstrating the operation of internal control activities for the period under audit. Examples include: <ul style="list-style-type: none"> Approval signature documentation (electronic or manual) demonstrating accuracy reviews of appropriation transactions recorded in the general ledger (compared to supporting documentation such as Appropriation Act/Public Law) Reconciliations of non-expenditure transfers recorded in the general ledger to OMB-approved Non-Expenditure Transfer Authorizations (SF-1151s) 	x	x		x	x
		9. System inventory list, listing of system users and their access privileges.				x	x
Tier 1	Asset Documentation	10. Physical inventory count documentation (inventory instructions, completed inventory count sheets (indicating items selected from the “book” and physically inspected on the “floor”), preparer/reviewer signatures and supporting documentation evidencing resolution of differences). Physical inventory counts must include sufficient statistical coverage of the population and comply with applicable requirements (e.g., DoDI 5000.64, Enclosure 3, Section 11)	x				
		11. Physical inventory count documentation (inventory instructions, completed inventory count sheets (indicating items selected from the “floor” and traced back to the “book”), preparer/reviewer signatures and supporting documentation evidencing resolution of differences). Physical inventory counts must include sufficient statistical coverage of the population and comply with applicable OUSD (AT&L) requirements.		x			
		12. Detailed listing of all assets from APSRs				x	
		13. Summary schedule reporting the amounts/quantities by class of assets				x	
		14. Reconciliation of the summary schedule of assets to the general ledger.				x	
		15. Policies and procedures relevant to the assets, demonstrating the consistency of accounting treatment across all years presented				x	
	Asset Documentation	16. Written definitions of asset classes and assessable units				x	
		17. Documentation demonstrating efforts made to obtain supporting documentation in cases where Tier 1 documentation is not used. Examples include data call requests, email traffic, meeting documentation, site visit inspection notes, etc.				x	
		18. Contract documentation, including (for base assets and asset modifications): <ul style="list-style-type: none"> Statement of Work Contract clauses that define who owns assets and when Reporting Entity takes possession Purchase Orders Receiving report or other acceptance document (e.g., DD250 (Materiel Inspection and Receiving Report) or DD1354 (Transfer and Acceptance of DoD Real Property)) 					x

Line Items	Documentation Type	Wave 3 – Mission Critical Asset E&C Audit Key Supporting Documents	Financial Statement Assertions				
			Existence	Completeness	Valuation	Presentation & Disclosure	Rights & Obligations
Tier 2		<ul style="list-style-type: none"> Deeds/titles (for Land only) Lease, Occupancy Agreement, Reversion Legal Document, Judgment Legal Document (for condemnation), Letter of Withdrawal (for withdrawal from Public Domain) 					
		19. Asset logs (e.g., maintenance logs or usage logs) that are reconciled to the APSR, demonstrating the completeness of the APSR population	x				
		20. Mission-management/logistics data (if different from the APSRs) used by leadership to track, deploy or distribute assets, reconciled to the APSR demonstrating the completeness of the APSR population		x			
		21. Tract maps, land plats, space management systems, utilities maps, or facility diagrams that are reconciled to the APSR, demonstrating the completeness of the APSR population					x
		22. Other estimation techniques that can be used to estimate the size of the population with tolerable precision and then compared to the APSR population to demonstrate completeness					x
		23. Physical indicators of ownership rights, including: <ul style="list-style-type: none"> Assets located on Reporting Entity facility Assets tagged with identification numbers (e.g., barcodes or tail numbers) that indicate Reporting Entity ownership Assets are marked with the Reporting Entity's name (or other coding or naming conventions) that demonstrate the Reporting Entities control over the asset Other evidence of exclusive rights to use assets 					x

When performing KSD testing, reporting entities may need to apply judgment when determining what documentation is sufficient to support all FROs, especially in instances where original source documentation is unavailable (e.g. using Tier 3 documentation). In instances when reporting entities determine Tier 1 documentation does not exist, reporting entities must consult with the FIAR Directorate prior to commencing KSD testing, to ensure both parties reach the same conclusion on the sufficiency of Tier 2 and Tier 3 documentation satisfying relevant FROs.

Financial Management Data

During physical inventory counts, entities must support and verify key data fields in the APSR to ensure that all information required for financial statement and management reporting is recorded and accurate. As part of the physical inventory counts, data should be recorded and testing performed for all selected items to confirm that the information in these data fields is accurate. The specific data fields that will be reviewed during an existence and completeness specified elements audit are summarized in the following table (refer to the FIAR Guidance website for the [Existence & Completeness Financial Management Data Fields definitions and supporting documentation](#)). The table separates data fields according to those that relate to financial statements, referred to as Financial Statement Data, and those that are primarily used as important management information referred to as Management and Budget Data.

Both categories of data are mandatory and must be validated in the APSR, because their reliability and accuracy are important for decision making. Prior to an assertion of audit readiness, management must ensure that the data is accurate in the APSR. The scope of an E&C audit will include a review of the data fields in the Financial Statement Data category (No. 1 through No. 16), in the following table. Auditors will then apply separate agreed-upon procedures on the Management and

Budget data fields to validate the accuracy of the management information. Note that some data fields may not apply to all asset types within the categories.

No.	General Title & Purpose	(PEP) ME & GE	(I&E) RP	(LM&R) Inv/OM&S
Financial Statement Data				
1	Individual Item Identifier – Used by the auditor to link the APSR asset record to the physical asset	Vehicle Identification Number, Serial Number, Tail Number, Unique Item Identifier	Real Property Site Unique Identifier, Real Property Unique Identifier (RPUID), Facility Number	Unique Item Identifier (for serially managed assets only)
2	Category/Asset Type – Used by the auditor to link the APSR asset record to the physical asset	National Stock Number (NSN), or if no NSN is available: Noun Name, Part Number, Manufacturer and Item Description	Real Property Asset Type Code; Real Property Asset Predominant Current Use CATCODE Code	NSN, Local Stock Number (LSN) when NSN is not available,
3	Location – Used by the auditor to link the APSR asset record to the location of the physical asset	Location information contained in data fields 7 and 8	Address Street Direction Code, Address Street Name, Address Street Number, Address Street Type Code, Country Code, County Code, City Code, Location Directions, State or Country Primary Subdivision Code, Postal Code	DoDAAC
4	Unit of Measure/Unit of Issue – Used by the auditor to count the quantity of items during physical inspection	N/A	Real Property Total Unit of Measure Code	Unit of Issue
5	Quantity – Used by the auditor to confirm the quantity of physical items during physical inspection	N/A	Real Property Total Unit of Measure Quantity	Quantity in APSR, Physical Quantity
6	Item Description – Used by the auditor to link the APSR asset record to the physical asset	Item Description	RPA Description Text	Item Description if NSN is not on item
7	Controlling/Financial Reporting Organization – Used by the auditor to confirm the reporting entity has rights to the asset	Accountable Organization	Real Property Asset Command Claimant Code; Real Property Asset Financial Reporting Org Code	Owning Organization
8	Custodial/User Organization – Used by the auditor to confirm the reporting entity has rights to versus use of the asset	Custodial Organization	Asset Allocation User Organization Code	Accountable Organization, Custodial Organization
9	Interest Code – Used by the auditor to confirm the reporting entity has rights to the asset	N/A	Real Property Asset Interest Type Code	N/A
10	Operational Status – Used by the auditor to confirm whether the asset is useable and correctly classified in the APSR	Status	Real Property Asset Operational Status Code	Current Condition Code
11	Placed-In-Service, Title Transfer, or Acquisition Date – Used by auditors to confirm the reporting entity's rights to the asset at a specific date	ME/GE Placed in Service and Acquisition Date	Real Property Asset Placed In Service Date	Title Transfer Date, Receipt Date for FOB Destination
12	Real Property Asset Historic Status Code – Used by auditors to confirm the asset is correctly classified as a heritage asset	N/A	Real Property Asset Historic Status Code	N/A
13	Real Property Asset Historical Status Date – Used by auditors to confirm the asset was correctly classified as a heritage asset at a specific date	N/A	Real Property Asset Historical Status Date	N/A
14	APSR – Used by the auditor to confirm the asset record is included in the reporting entity's APSR	APSR	APSR	APSR

No.	General Title & Purpose	(PEP) ME & GE	(I&E) RP	(LM&R) Inv/OM&S
15	Asset Review Date – Used by the auditor to confirm the most recent date the asset was physically inspected by management as part of its physical inventory control	Inventory Date	Asset Review Date	Inventory Date
16	Asset Review Type – Used by the auditor to confirm the type of review management performed over the asset as part of its physical inventory control	N/A	Asset Review Type Code	N/A
Management and Budget Data				
17	Condition – Used by auditors to verify the asset's current condition	Current Condition Code	Facility Physical Quality Rate	
18	Acquisition Cost – Used by auditors to confirm the recorded asset acquisition cost is adequately supported	Original Acquisition Cost		
19	Usage – Used by the auditor to confirm the operational status of the asset	Usage Data		
20	Secondary Unique Identifier - Used by the auditor to link the APSR asset record to the physical asset	UII or DoD recognized IUID		Controlled Inventory Item Code (CIIC), if applicable
21	Replacement Value – Used by auditors to confirm the recorded replacement value is supported		Facility Plant Replacement Value Amount	
22	Utilization Rate – Used by the auditor to verify the accuracy of utilization data used in capital planning		Real Property Asset Utilization Rate	
23	Allocation Quantity – Used by the auditor to confirm the quantity of physical items during physical inspection		Asset Allocation Size Quantity	
24	Allocation Unit of Measure– Used by the auditor to count the quantity of items during physical inspection		Asset Allocation Size Unit of Measure Code	
25	Grantee – Used by the auditor to confirm the reporting entity has rights to the asset		Grantee Organization Code	
26	Grantor – Used by the auditor to confirm the reporting entity has rights to the asset		Grantor Organization Code	
27	Grant Start Date - Used by auditors to confirm the reporting entity's rights to the asset at a specific date		Grant Start Date	
28	Grant End Date - Used by auditors to confirm the reporting entity's rights to the asset at a specific date		Grant End Date	

C.3.3 Example Work Products

Refer to the FIAR Guidance website for [Wave 3 specific work products](#) and related guidance.

C.3.4 Wave-Specific Audit Execution

Wave 3 focuses primarily on the E&C financial statement assertions for select asset accounts (ME, RP, GE, Inventory, and OM&S). Reporting entities should break these general asset categories into subsidiary assessable units that they deem appropriate and logical given their asset composition.

Reporting entities must prepare and submit assertion documentation (i.e., risk assessments, control assessments, process narratives, test plans, etc.) to the FIAR Directorate as they complete the key tasks and activities in the Discovery and Corrective Action

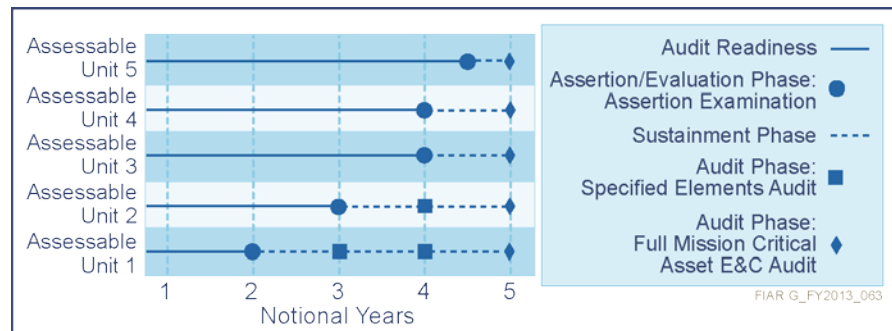


Figure 5. E&C Audit Strategy

Phases. The FIAR Directorate will review the assertion documentation and provide feedback to the reporting entities on an ongoing basis. Once a reporting entity asserts that it is ready to undergo an examination of its Wave 3 assessable unit(s) by the DoD OIG, the FIAR Directorate will validate that all key audit readiness dealbreakers (i.e., reconciled population, sufficient testing of control activities, etc.) have been sufficiently addressed.

The DoD OIG will then perform an audit readiness examination during the *Assertion / Evaluation Phase* to form an opinion on the reporting entity's audit readiness assertion, as shown in Figure 5. If the examination results in an unqualified opinion on the reporting entity's audit readiness assertion, the DoD OIG will perform annual specific elements audits on the assessable unit. As the reporting entity asserts additional assessable units as audit ready, and the DoD OIG's examinations result in unqualified opinions on these additional assessable units, the DoD OIG will expand the scope of its annual specified elements audits to include these additional units. The level of effort associated with E&C audits is expected to decrease in subsequent years as the control **activities** associated with the receipt of goods and services included in the Procure-to-Pay and Acquire-to-Retire processes provide evidence of E&C sustainability. Should these audits demonstrate a strong and effective control environment, the reporting entity can submit a request to the FIAR Directorate to substitute a cycle other than annually for audits.

C.4 WAVE 4 – FULL AUDIT EXCEPT FOR EXISTING ASSET VALUATION

Assertions for this wave include all material reporting entity line items, account balances and financial transactions impacting the Balance Sheet, Statement of Net Cost, and Statement of Net Position not covered by Waves 2 or 3 (i.e., Environmental and Disposal Liability). **The FIAR priorities require reporting entities to devote their resources and efforts towards completing Waves 1 through 3 before beginning work on Wave 4. Nevertheless, much of the work to complete Waves 1 through 3 impacts the requirements and objectives for Wave 4. For example, the following interdependencies will be leveraged to accelerate progress in Wave 4:**

- **Delivered Orders, reported on the SBR (covered in Wave 2), equate to a portion of Accounts Payable reported on the Balance Sheet**
- **Spending Authority from Offsetting Collections, reported on the SBR (covered in Wave 2), includes some of the amounts reported in Accounts Receivable –Intragovernmental on the Balance Sheet**
- **Unobligated Balances and Unpaid Obligations, reported on the SBR (covered in Wave 2), correlate to Fund Balance with Treasury (FBWT) reported on the Balance Sheet**
- **Obligations Incurred, reported on the SBR (covered in Wave 2), equates to a substantial portion of Gross Costs reported on the Statement of Net Cost.**

In addition, this wave adds the valuation assertion for assets (i.e., RP, GE, Inventory, and OM&S). **One significant and potentially very costly challenge in Wave 4 is obtaining auditable values for the significant amount of existing DoD assets located worldwide and procured many years ago, well before passage of the CFO Act and other legislation mandating auditability. As required by Congress, the Department performed a business case analysis, examining various options for valuing and reporting assets on DoD financial statements.** The business case concluded that the cost to obtain such information would not be justified by the value of obtaining such information. Therefore, the Department has determined that existing assets will not be subject to the valuation assertion. Refer to 2.E for additional details regarding the business case.

C.4.1 Readiness Scope

Reporting entity audit readiness efforts must include all remaining processes, controls, and supporting documentation that result in financial transactions and balances that are material to their financial statements, except for those related to existing asset valuation. To effectively remediate new PP&E acquisition processes, reporting entities must identify the date they will be able to establish processes and practices (i.e., adequate systems and internal control practices) for future acquisitions. This is consistent with another conclusion from the business case, the Department will not spend resources to support the capitalized cost of existing GE, RP, Inventory, and OM&S until it has the capability to capture transaction costs and retain documentation to support the recorded amounts.

Because reporting entities are at different stages in implementing new information technology systems and in improving business processes they must individually establish dates by type of asset – effectively acquisition dates – after which they expect to have supportable acquisition cost information. Depending on the type of asset and the reporting entity, those dates may be in the past or in the future after a reporting entity implements a new system or systems. For example, a reporting entity may have had effective processes and control **activities** for real property since FY 2004. In that instance, the reporting entity could assert that the historical cost amounts for real property acquired during or after FY 2004 are auditable. Another reporting entity might not be able to assert that the historical cost information for its inventory is auditable until it completes implementation of an ERP. The selected dates must be disclosed in the financial statements and when asserting audit readiness.

C.4.2 Risks, Financial Reporting Objectives and Key Supporting Documents

Risks

The following table presents the key ROMM related to Wave 4, including those specific to the valuation of new asset acquisitions. A reference to the source of each risk is included in parentheses. **Reporting entities must achieve the FROs relevant to the subject matter, assertion, or processes (e.g., contract pay), to demonstrate audit readiness.** Refer to the FROs in the table following this table for further details.

Wave 4 – Full Audit Except for Existing Asset Valuation Key Risks of Material Misstatement	
Financial Statement Assertion	Key Risks of Material Misstatement
Existence	1. Recorded pension amounts are not representative of pensions earned by employees. (FAM 395B: 1)
	2. Recorded Environmental Liabilities are not representative of legal environmental costs incurred by the entity. (FAM 395B: 1)
	3. Recorded Environmental Liabilities do not pertain to the entity. (FAM 395B: 1)
	4. Advances from Others, Accrued Unfunded Annual Leave and/or Contingent Liabilities do not pertain to the entity. (FAM 395B: 1)
	5. Recorded Non-Exchange Revenue does not represent economic events that actually occurred or do not pertain to the entity. (FAM 395B: 1)
	6. Imputed Financing costs do not represent economic events that actually occurred or do not pertain to the entity. (FAM 395B: 1)
	7. Recorded Depreciation Expense does not represent depreciation cost incurred by the related asset. (FAM 395B: 1)
	8. Transactions are recorded in the current period but the related economic events occurred in a different period. (FAM 395B: 2)*
	9. Transactions are summarized improperly, resulting in an overstated total. (FAM 395B: 3)*
	10. Recorded assets and liabilities do not exist at a given date. (FAM 395B: 4)**
	11. Adjusting entries are not representative of events that actually occurred, were not properly classified or supported by valid supporting documentation. (FAM 395B: 1c)*
Completeness	12. Valid pension liabilities were not recorded or are improperly summarized. (FAM 395B: 5)
	13. Valid Environmental liabilities were not recorded or are improperly summarized. (FAM 395B: 5)
	14. Advances from Others, Accrued Unfunded Annual Leave and/or Contingent Liabilities were not recorded or were improperly summarized. (FAM 395B: 5)
	15. Valid Exchange Revenue transactions were not recorded or were improperly summarized. (FAM 395B: 5)
	16. Valid Imputed Financing transactions were not recorded or were improperly summarized. (FAM 395B: 5)
	17. Depreciation Expense was not recorded or was improperly summarized. (FAM 395B: 5)
	18. Economic Events occurred in the current period, but the related transactions are recorded in a different period. (FAM 395B: 6)*
	19. Transactions were summarized improperly, resulting in an overstated total. (FAM 396B: 7)*
	20. Assets and liabilities of the entity exist but are omitted from the financial statements. (FAM 395B: 8)**
Valuation	21. Transactions were recorded at incorrect amounts. (FAM 395B: 9)
	22. Assets and liabilities included in the financial statements are valued at incorrect amounts. (FAM 395B: 10)
	23. Assets and related book values included in the financial statements are valued on an appropriate basis. (FAM 395B: 10)
	24. Revenues and expenses included in the financial statements are measured improperly. (FAM 395B: 11)

Wave 4 – Full Audit Except for Existing Asset Valuation Key Risks of Material Misstatement	
Financial Statement Assertion	Key Risks of Material Misstatement
Presentation and Disclosure	25. Accounts or the transactions they accumulate are not properly classified and described in the financial statements. (FAM 395B: 15)*
	26. The current period financial statement components are based on accounting principles different than those used in the prior periods presented. (FAM 395B: 16)*
	27. Information needed for fair presentation in accordance with U.S. GAAP is not disclosed in the financial statements or in the related footnotes. (FAM 395B: 17)*
Rights and Obligations	28. The entity does not have an obligation for recorded liabilities at a given date. (FAM395B: 14)
* Risks applies to all line items	
** Risks apply to balance sheet line items.	

Note: This table only includes a sample of information and will be expanded in a future version of the FIAR Guidance.

Financial Reporting Objectives

Reporting entities must identify and implement a combination of control activities and supporting documentation to demonstrate that the FROs, relevant to the subject matter, assertion, or processes, (e.g., contract pay) have been achieved. Each FRO has been linked to its relevant financial statement assertions (as indicated with an “X” in the relevant columns), including if the FRO relates to compliance with laws and regulations. At the end of each FRO is a source reference. This is not a complete listing of control objectives, but rather those FROs needed to address key risk areas most likely to be present based on the Department's experience. Reporting entities must apply judgment to determine if additional FROs should be included given their specific business processes and financial statements. Reporting entities may also refer to the GAO/PCIE FAM Section 395B for a list of general control objectives based on financial statement assertions.

Wave 4 – Full Audit Except for Existing Asset Valuation Financial Reporting Objectives						
Assets & Liabilities Categories	Financial Reporting Objectives	Financial Statement Assertions				
		Existence	Completeness	Valuation	Presentation & Disclosure	Rights & Obligations
Military Equipment	1. Ensure balances and related footnote disclosures contain all information needed for fair presentation in accordance with U.S. GAAP (FAM 395B: 15, 16, and 17). **				x	
Real Property	2. Ensure all assets are recorded at full cost in the general ledger at correct amounts (FAM 395B: 9, 10).			x		
General Equipment ¹⁶	3. Ensure the net book value of assets is accurate and related depreciation, depletion and amortization is accumulated, based on the capitalized cost, useful life, date of service, and salvage value, if applicable (FAM 395B: 10).			x		
	4. Ensure transferred, sold, excess, unusable, or idle GE assets are timely and properly recorded at correct amounts (FAM 395B: 9, 10).			x		
Inventory	5. Ensure balances and related footnote disclosures contain all information needed for fair presentation in accordance with U.S. GAAP (FAM 395B: 15, 16, 17). **				x	
Operating Material and Supplies	6. Ensure all assets are recorded at full cost in the general ledger at correct amounts (FAM 395B: 9, 10).			x		
	7. Ensure transferred, sold/consumed, excess, unusable, or idle assets are timely and properly recorded (FAM 395B: 10).			x		

¹⁶ The PP&E Category for Wave 4 only addresses financial reporting objectives as they relate to the Accuracy & Valuation and Presentation & Disclosure Assertions. The financial reporting objectives addressing Existence and Completeness are discussed in Wave 3, “Mission Critical Asset E&C Audit”.

Wave 4 – Full Audit Except for Existing Asset Valuation Financial Reporting Objectives							
Assets &Liabilities Categories	Financial Reporting Objectives	Financial Statement Assertions					Compliance
		Existence	Completeness	Valuation	Presentation & Disclosure	Rights & Obligations	
Military Retirement Health Benefits	8. Ensure actuarial calculations related to military retirement benefits are supported by complete and accurate data, and valid assumptions that comply with specified laws and regulations.	x	x	x		x	
	9. Ensure military retirement benefits accruals are properly allocated across appropriate reporting periods (FAM 395B: 2, 6).	x	x				
	10. Ensure actuarial calculations related to military retirement benefits are summarized and recorded in the financial statements accurately (FAM 395B: 3, 7, 9).	x	x	x			
	11. Ensure Military Retirement Health Benefit accrual balances and related footnote disclosures contain all information needed for fair presentation in accordance with U.S. GAAP (FAM 395B: 15, 16, 17).**					x	
Environmental Liabilities	12. Ensure Environmental Liabilities balances and related footnote disclosures contain all information needed for fair presentation in accordance with U.S. GAAP (FAM 395B: 15, 16, and 17).**					x	
	13. Ensure all potential Environmental Liabilities are recorded at full cost in the general ledger (FAM 395B: 9, 10).			x			
	14. Ensure consistent use of appropriate methodologies for valuing Environmental Liabilities (FAM 395B: 16).			x			
	15. Ensure Environmental Liabilities are properly allocated across appropriate reporting periods (FAM 395B: 2, 6).	x	x				
	16. Ensure calculations related to Environmental Liabilities are summarized and recorded in the financial statements accurately (FAM 395B: 3, 7, 9).	x	x	X			
Advances from Others	17. Ensure advances from others and accrued unfunded annual leave represent events that actually occurred, are properly classified, and pertain to the entity (FAM 395B: 1c).	x					
Accrued Unfunded Annual Leave Contingent Liabilities	18. Ensure that appropriate individuals approve recorded contingent liabilities in accordance with management's general or specified criteria (FAM 395B: 1b).	x					
	19. Ensure advances from others, accrued unfunded annual leave, and contingent liabilities are properly allocated across appropriate reporting periods (FAM 395B: 2, 6).	x	x				
	20. Ensure all valid transactions related to advances from others, accrued unfunded annual leave, and contingent liabilities are summarized and recorded in the financial statements accurately (FAM 395B: 3, 5, 7, 9).	x	x	x			
	21. Ensure recorded advances from others, accrued unfunded annual leave, and contingent liabilities are the entity's obligation at a given date (FAM 395B:14).					x	
	22. Ensure advances from others, accrued unfunded annual leave, and contingent liabilities balances and related footnote disclosures contain all information needed for fair presentation in accordance with U.S. GAAP (FAM 395B: 15, 16, 17).**				x		
Non-Exchange Revenue	23. Ensure recorded non-exchange revenue transactions, underlying events, and related processing procedures are authorized by federal laws, regulations, and management policy (FAM 395B: 1a).	x					
	24. Ensure recorded non-exchange revenue transactions represent events that actually occurred, are appropriately classified, and pertain to the entity (FAM 395B: 1c).	x					
	25. Ensure non-exchange revenue transactions are properly allocated across appropriate reporting periods (FAM 395B: 2 and 6).	x	x				
	26. Ensure all valid non-exchange revenue transactions are summarized and recorded in the financial statements accurately (FAM 395B: 3, 5, 7, 9).	x	x	x			

Wave 4 – Full Audit Except for Existing Asset Valuation Financial Reporting Objectives						
Assets &Liabilities Categories	Financial Reporting Objectives	Financial Statement Assertions				Compliance
		Existence	Completeness	Valuation	Presentation & Disclosure	Rights & Obligations
	27. Ensure non-exchange revenue included in the financial statements are measured properly (FAM 395B: 11).			x		
	28. Ensure the entity has the rights to the recorded non-exchange revenue (FAM 395B: 13).					x
	29. Ensure non-exchange revenue balances contain all information needed for fair presentation in accordance with U.S. GAAP (FAM 395B: 15, 16, 17).**				x	
All Line Items	30. Adjusting entries are representative of events that actually occur, are properly classified and supported by valid supporting documentation(FAM 395B:1c).	x			x	
	31. Recorded assets and related processing procedures are authorized by federal laws, regulations, and management policy (FAM 395B: 1a)					x
	32. Access to assets, critical forms, records, and processing and storage areas is permitted only in accordance with laws, regulations, and management policy (FAM 395B: 4c)					x
	33. Persons do not have uncontrolled access to both assets and records; they are not assigned duties to put them in a position that would allow them to both commit and conceal errors or fraud (FAM 395B: 18)				x	
**Components should review applicable sections of the GAO/PCIE FAM section 2010 Federal Accounting Checklist and 2020 Federal Reporting and Disclosure Checklists to ensure proper presentation and disclosures.						

Note: This table only includes a sample of information and will be expanded in a future version of the FIAR Guidance.

Key Supporting Documents

The following table lists the minimum internal controls documentation and supporting documentation required to support activity and balances asserted as audit-ready for Wave 4. Each document indicates which financial statement assertions are potentially met by that specific document. Internal control documentation is marked as satisfying all financial statement assertions, because the specific control activities described in the internal control documentation will determine which financial statement assertions are met.

Wave 4 – Full Audit Except for Existing Asset Valuation Key Supporting Documents								
Key Supporting Documents			Financial Statement Assertions					
			Existence	Completeness	Valuation	Presentation & Disclosure	Rights & Obligations	
All Financial Statement Line Items	Internal Control Documentation	1.	Statement-to-process analyses quantifying the dollar amount and volume of activity flowing through various processes and/or locations			x		
		2.	Applicable policies and procedures			x		
		3.	Process narratives and flowcharts			x		
		4.	Control worksheets, identifying risks, FROs and corresponding control activities			x		
		5.	Test plans documenting detailed procedures used to test the operating effectiveness of control activities			x		
		6.	Control assessments with test results			x		
		7.	Evaluation of test results			x		
		8.	Documentation evidencing the operation of internal control activities for the period under audit. Examples include: <ul style="list-style-type: none">Approval signature documentation (electronic or manual) demonstrating authorization for an acquisitionSystem edit checks alerting users that new obligations are for proper purpose and amountAPSRs balances that reconcile to general ledger balances					
		9.	System inventory list, listing of system users and their access privileges.					
Asset Documentation	Transaction Documentation	10.	Obligating documents such as contracts, reimbursable agreements, MIPRs, purchase orders, travel orders, payroll documents, etc.			x		
		11.	Physical inventory count documentation (inventory instructions, completed inventory count sheets (indicating items selected from the “book” and physically inspected on the “floor”), preparer/reviewer signatures and supporting documentation evidencing resolution of differences). Physical inventory counts must include sufficient statistical coverage of the population and comply with applicable OUSD (AT&L) requirements.			x		
		12.	Detailed listing of all assets from APSRs			x		
Military Retirement Health Benefits		13.	Summary schedule reporting the amounts/quantities by class of assets			x		
		14.	Reconciliation demonstrating how totals in the detail listing agree to the amounts/quantities reported in the summary schedule			x		
		15.	Detail listing of factors, data, assumption, and formulas used to prepare the actuarial calculations for each sub-process involved in the projection.		x	x		
Imputed Financing Sources		16.	Documentation supporting any significant changes in actuarial calculations from prior year.			x		
		17.	Documentation supporting evaluation of actual to expected results supporting accuracy of models used.	x	x	x		x
		18.	Detail listing of amounts paid during the fiscal year from the Federal Judgment Fund to settle lawsuits and claims against the entity			x		

Wave 4 – Full Audit Except for Existing Asset Valuation Key Supporting Documents							
Key Supporting Documents			Financial Statement Assertions				
			Existence	Completeness	Valuation	Presentation & Disclosure	Rights & Obligations
Environmental Liabilities	19.	Reconciliation of the detail listing of all environmental liabilities to the amounts reported in the general ledger and financial statements, including appropriate explanations for reconciling items	x	x	x		x
	20.	Record of Decision (ROD)	x		x		x
	21.	Contract, invoices, receiving reports/status reports	x		x		
	22.	Other clean-up cost estimates, if applicable			x		
	23.	Data call results of site inspections, comparisons to EPA listings, other publicly available RCRA/CERCLA supporting documentation, etc. used to identify the complete population of environmental liabilities		x			
Advances from Others	24.	Ordering Document: MIPR, Reimbursable Agreement, Customer Order, etc.	x				x
	25.	IPAC/Goals report evidencing amounts advanced			x		
	26.	Invoices, IPAC billings (using GOALS reports) supporting any reductions of advances for amounts earned			x		
Accrued Unfunded Annual Leave	27.	Individual employee-level listing of hours, hourly rates, and total dollar amount of unfunded leave liability that reconciles to amount recorded in the financial statements		x	x		
	28.	Timesheets & leave earning reports that support the amount of leave taken and earned, respectively, by pay period for individual employees			x		x
	29.	SF-50s & SF-52s that support the hourly rate for leave liability calculation (supporting the grade/step/locality) for individual employees	x		x		
Contingent Liabilities	30.	Legal representation letter prepared by the Office of General Counsel (in accordance OMB Bulletin No. 07-04, Section 9)	x	x	x		x
	31.	Management's schedule of legal liabilities (in accordance OMB Bulletin No. 07-04, Section 9)	x	x	x		x
Non-Exchange Revenue	32.	Public law demonstrating authority to collect non-exchange revenue					x
	33.	Deposit tickets (SF-215s), IPAC/GOALS reports, supporting cash collection dollar amounts	x		x		
	34.	Other support to demonstrate completeness of reported revenue (e.g., reconciliation to trust fund collections)		x			
Depreciation Expense	35.	DD-250, Receiving Report or DD-1354 to support placed in service date for asset			x		
	36.	Mathematical calculations supporting recorded depreciation expense (demonstrating that the system is correctly calculating depreciation expense for a sample of assets, appropriately considering additions/betterments, etc. that may affect useful lives and acquisition costs over the life of assets)			x		

Note: This table only includes a sample of information and will be updated in a future version of the FIAR Guidance.

C.4.3 Example Work Products

See Sections C.2.3 and C.3.3 for Wave 2 and Wave 3 specific work product examples.

C.4.4 Wave-Specific Audit Execution

Entities completing Wave 4 should be ready for a full-scope financial statement audit except for existing asset valuation. To prepare for full-audit, a reporting entity must clearly define and disclose what they classify as existing assets, in writing, to provide its auditors with clear boundaries of what is outside the scope of its audit readiness effort. Using this information, the auditor will be able to determine the impact of not having auditable costs for existing assets in relationship to the financial statements taken as a whole, the impact of which could result in a qualified or disclaimer of opinion.

APPENDIX D – FIAR METHODOLOGY DETAILS

This appendix provides FIAR Methodology (Methodology) details for reporting entities and service providers working to become audit ready related to tests of controls, tests of supporting documentation, and document retention requirements.

TESTS OF CONTROLS

The following sections provide additional guidance related to Methodology Activities 1.3.1 to 1.3.5 included in **Figure 1** below as it relates to assessing entity-level controls and assessable unit control activities.

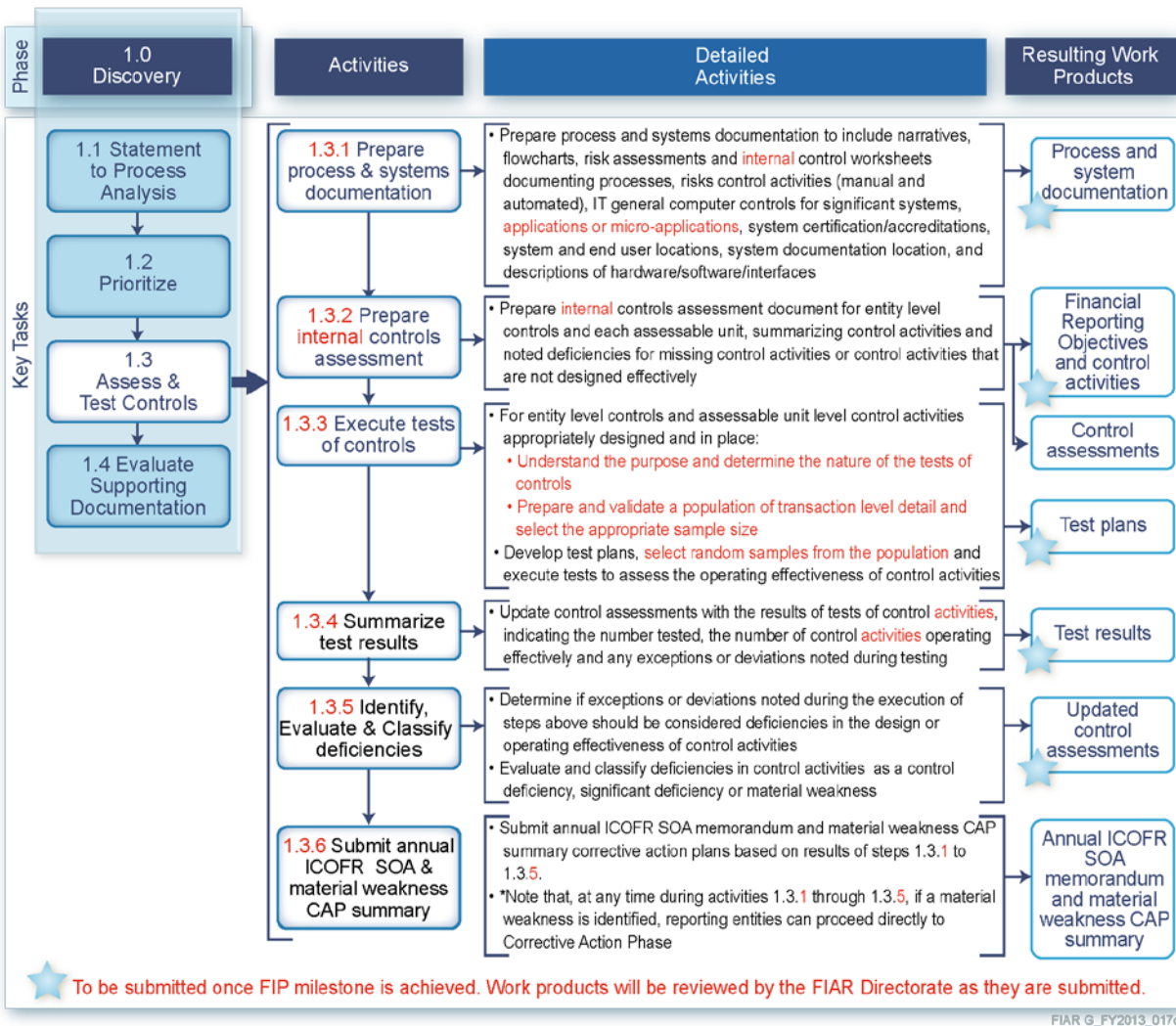


Figure 1. Discovery – Assess & Test Controls

D.1 ASSESSMENT OF ENTITY-LEVEL CONTROLS

The U.S. Government Accountability Office (GAO) issued internal control standards for Federal entities in the “Standards for Internal Control in the Federal Government,” also referred to as the “Green Book.” GAO also issued the “Internal Control Management and Evaluation Tool”, based upon guidance provided by GAO’s Green Book, to assist agencies in maintaining or implementing effective internal control, and improving or maintaining effective operations. The Office of Management and Budget (OMB) has issued guidance, OMB Circular A-123, “Management’s Responsibility for Internal Control, to assist Federal managers with improving the accountability and effectiveness of Federal programs and operations by establishing, assessing, correcting, and reporting on internal control. The standards promulgated by GAO’s Green Book, and internal control guidance provided by GAO’s Management and Evaluation Tool and OMB Circular A-123 collectively define the minimum level of quality acceptable for internal control in government and provide the basis against which internal control is to be evaluated. However, they are not intended to limit or interfere with duly granted authority related to developing legislation, rule making, or other discretionary policy-making in an agency. In implementing these standards, management is responsible for developing the detailed policies, procedures, and practices to fit their agency’s operations and to ensure that they are built into and are an integral part of operations. The five components of the standard, as noted on **Figure 2**, represent the entity-level controls of an organization. Weaknesses or deficiencies within these foundation controls weaken other internal controls, such as control activities at the assessable unit level. **Therefore, reporting entities and service providers should begin their controls assessments with an evaluation of entity-level controls, which will then serve as a basis for the reporting entities’ financial improvement and audit readiness plans.**

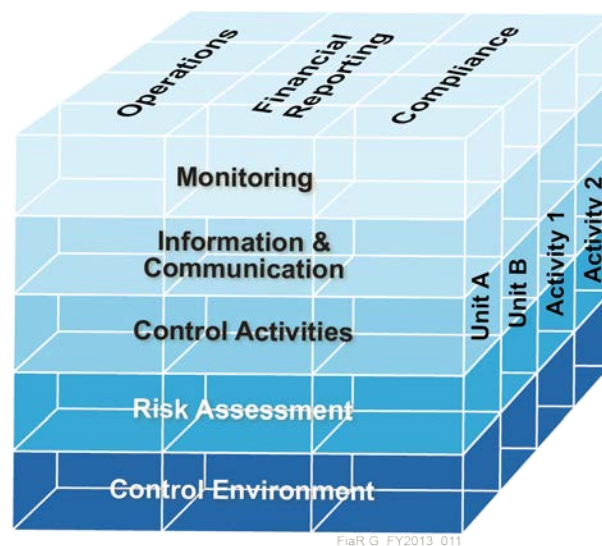


Figure 2. Standards for Internal Control in the Federal Government – Entity-Level Controls

The five components of entity-level controls are defined as:

- **Control Environment** – Structure and culture created by DoD management and employees to sustain organizational support for effective internal control. The control environment is often called the “tone at the top” and is critical to the success of all the other pieces of the internal control framework.
- **Risk Assessment** – Management’s identification of internal and external risks that may prevent the Department from meeting its objectives. The risk assessment is the basis for all other control activities. The identification should include risks related to new or revamped information systems implemented by the reporting entity or its service provider. For example, the service provider may implement a client-server version of its software that was previously run on a mainframe. Although the new software may perform similar functions, it may operate so differently that it affects the reporting entity’s operations.
- **Control Activities** – Policies, procedures, and mechanisms in place to help ensure that the Department’s objectives are met. Control activities, both manual and automated, are the day-to-day

actions that are at the core of internal controls. These control activities include information technology general controls (ITGCs) over all financially significant computer applications, automated application controls over financial transaction balances within computer applications, and manual application controls performed outside of computer applications.

- **Information and Communication** – Relevant, reliable, and timely information is communicated to appropriate personnel at all levels within the Department. Information and communication ensures that internal controls are flexible enough to respond to changes in the control environment.
- **Monitoring** – Periodic reviews, reconciliations, or comparisons of data should be part of the regular assigned duties of personnel. Monitoring is the process that ensures the control structure is operating as planned and fills all gaps that may exist in the internal control structure. Monitoring the effectiveness of internal controls is part of the normal course of business.

Addressing entity-level controls requires a well-planned approach. Additional guidance specific to the evaluation of entity-level controls within the *Discovery phase*, “Assess & Test Controls” task of the Methodology, is included below.

D.1.1 Prepare Process and System Documentation (Activity 1.3.1)

The first step is to identify and document key entity-level controls. Entity-level controls should be considered at the reporting entity and/or service provider-wide level and at their individually important locations. Documentation should include a description of each of the following four components of entity-level controls:

- **Control Environment**, including code of conduct, Human Capital (HC) policies, tone-at-the-top, senior management effectiveness, and anti-fraud programs;
- **Risk Assessment**, including management’s fraud and financial reporting risk assessment processes;
- **Information and Communication**, including management’s process for identifying changes in accounting standards and communicating new policies and procedures within the organization; and
- **Monitoring**, including internal reviews and self-assessment activities.

Control activities are incorporated into the business processes and sub-processes, and are documented and tested separately from the entity-level control components.

D.1.2 Prepare Internal Controls Assessment (Activity 1.3.2), Execute Tests of Controls (Activity 1.3.3), and Summarize Test Results (Activity 1.3.4)

Once entity-level controls have been identified and documented, the reporting entity should develop a process for testing entity-level controls and summarizing results (Activities 1.3.2 – 1.3.4). Entities must assess entity-level controls annually. A reporting entity should consider using GAO’s Internal Control Management and Evaluation Tool (found at <http://www.gao.gov/new.items/d011008g.pdf>), which is based on the GAO Green Book, to assist in the assessment process. The tool was developed by the GAO to assist agencies in assessing entity-level controls, and help determine what, where, and how improvements can be implemented. The tool provides a systematic, organized, and structured approach for assessing the internal control structure of an organization.

Because entity-level controls are the foundation for all other control activities implemented within DoD, these control activities must be assessed as early in the FIAR process as possible.

Inadequate entity-level controls may be an indication that the control environment is weak or ineffective. Weaknesses or deficiencies identified within these foundation control activities must be remediated as soon as possible to prevent the weakening of other internal controls.

D.1.3 Identify, Evaluate and Classify Deficiencies (Activity 1.3.5)

The identification, evaluation, and classification of deficiencies should be conducted in the same manner for entity-level controls and assessable units. However, the evaluation of the results of entity-level assessments requires significant judgment. When deficiencies are identified, it is important to begin Corrective Action phase activities quickly, given the importance and pervasive nature of entity-level controls. For example, systemic issues with respect to the assignment of authority, the development and communication of policies and procedures, or management's anti-fraud programs are not quick fixes and may take several weeks to months to address.

D.2 ASSESSABLE UNIT INTERNAL CONTROL TESTING & EVALUATION OF DEFICIENCIES

Reporting entities and service providers must obtain a high level of assurance that internal controls over financial reporting are working effectively when performing test of controls to support the audit readiness assertion of an assessable unit. **The entity must obtain sufficient, competent evidence about the design and operating effectiveness of control activities over all relevant financial statement assertions related to the assessable unit.** More guidance related to the testing of assessable unit controls within the *Discovery Phase*, “Assess & Test Controls” task of the Methodology is included below.

D.2.1 Prepare Process and Systems Documentation (Activity 1.3.1)

The entity must prepare process and systems documentation to include narratives, flowcharts, risk assessments and internal control worksheets documenting processes, risks (linked to financial statement assertions), control activities (manual and automated), IT general computer controls for significant systems, applications or micro-applications, system certification and accreditations, system and end user locations, system documentation location, and descriptions of hardware, software, and interfaces.

DOCUMENTATION MUST DIFFERENTIATE BETWEEN BUSINESS PROCESSES AND RELATED CONTROL ACTIVITIES

Business processes consist of a sequence of activities that are performed in order to accomplish work and achieve the business's objectives. These activities may range from a simple procedure, such as paying an invoice, to a key element of the business operations, such as processing civilian pay or purchasing missiles. They may also include functional processes, such as maintaining an organization's financial records, to cross-functional processes, such as human resource management.

Control activities are the policies, procedures, techniques, and mechanisms that help make certain that management directives are carried out. Control activities include: business performance reviews, controls over information processing (e.g., application controls and IT general controls (ITGCs), physical controls, and segregation of duties).

Business process should not be confused with control activities, which are the procedures established by management to ensure that business processes are carried out as directed, while providing the organization with reasonable assurance that misstatements of the financial statements will be prevented or detected in a timely manner. **Figure 3** provides examples of these concepts.

Business Process	Business Sub-Process	Sub-Process Risk	Financial Reporting Objectives	Control Activity
Civilian Payroll	Payroll Computation	Payroll may be calculated incorrectly	Salary and benefits are calculated, paid, and recorded based on applying appropriate data from accurate formulas, calculations, and/or data processing.	Payroll technicians review the report which identifies payments less than \$1 and greater than \$5,000/\$10,000 for civilians on their respective databases and review their payroll system records to determine whether they were valid payments. If the net amount for each employee/item is greater than \$5,000/10,000 or less than \$1, the report is annotated and updates are made in the payroll system for any invalid payments.
Civilian Payroll	Payroll Computation	Invalid payroll payments may be made to employees	Only valid payroll disbursements and collections are included in the outlays section of the Statement of Budgetary Resources.	Payroll technicians review the Master Pay History and Master Employee Record, in both databases, for each employee on the duplicate Social Security number listing to determine if an overpayment exists and if the employee should be separated.

Figure 3. Examples of Civilian Payroll Control Activities

ENSURE COMPLETENESS OF IT DOCUMENTATION

The description of information technology (IT) systems must include all automated systems and technology tools used during the execution of the processes related to the assessable unit,

including financial systems, mixed-systems, non-financial systems, and micro- applications (i.e., spreadsheets, databases, and/or other automated tools used to perform reconciliations, calculations, or other business functions). The purpose of each IT system or tool must be documented. A system view diagram should be completed as part of Activity 1.3.1 to include all systems and automated tools used during the execution of the processes related to the assessable unit. Refer to Section 3.A.4, **Figure 14**, for an example of a system view diagram. **Tests of control activities related to automated controls and/or tests of the integrity of automated tools must be performed.** Refer to Section D.2.3 for additional guidance related to execution of tests of controls.

D.2.2 Prepare Controls Assessment (Activity 1.3.2)

The reporting entity or service provider must first identify the control activities to be tested. **They must evaluate control activities to determine if they have been designed effectively (i.e., designed to meet the financial reporting objectives).** The design effectiveness of control activities is based on the following criteria: (1) Directness (extent control activity relates to control objective), (2) selectivity (magnitude of amount of dollar activity not subject to the control), (3) manner of execution (frequency of control activity execution and skills/experience of personnel performing the control activity), and (4) follow-up (procedures performed when the control activity identifies an exception or reconciling item). The entity will only test effectively designed control activities (i.e., those that achieve the applicable **FROs**) for operational effectiveness.

AVOID DUPLICATION OF EFFORTS WITH OTHER SIMILAR ACTIVITIES

The reporting entity should identify other assessments where controls have been identified for testing and coordinate the efforts to avoid duplication of efforts with other similar entities. For example, agencies are required to perform reviews of financial systems under the Federal Financial Management Improvement Act (FFMIA), the DoD Manager's Internal Control (MIC) Program, or information security under the Federal Information Security Management Act (FISMA). Reviews performed by entities or at the entity's discretion may be used to help accomplish this assessment. This is not to suggest that the entity can avoid sampling and testing control activities. Rather, an entity can use alternative sources of evidence (if available) in combination with detailed sample testing to achieve a high level of assurance.

Possible sources of information may come from¹⁷:

- Management knowledge gained from the daily operation of agency programs and systems.
- Management reviews conducted (1) expressly for the purpose of assessing internal control, or (2) for other purposes with an assessment of internal control as a by-product of the review.
- Inspector General and GAO reports, including audits, inspections, reviews, investigations, outcome of hotline complaints, or other products.
- Program evaluations.
- Audits of financial statements conducted pursuant to the CFO Act, as amended, including: information revealed in preparing the financial statements; the auditor's reports on the financial statements, internal control, and compliance with laws and regulations; and any other materials prepared relating to the statements.
- Reviews of financial systems which consider whether the requirements of FFMIA and OMB Circular No. A-127, Financial Management Systems are being met.
- Annual evaluations and reports pursuant to FISMA and OMB Circular No. A-130, Management of Federal Information Resources.
- Annual performance plans and reports pursuant to the Government Performance and Results Act of 1993.
- The American Recovery and Reinvestment Act of 2009 (ARRA) reporting requirements¹⁸.

¹⁷ OMB Circular A-123, Appendix A, p. 13.

- Annual reviews and reports pursuant to the Improper Payments Information Act of 2002, amended by the Improper Payments Elimination and Recovery Act of 2010.
- Single Audit reports for grant-making agencies.
- Reports and other information provided by the congressional committees of jurisdiction.
- Other reviews or reports relating to agency operations, including service-level audit reports.
- Type 2 SSAE No. 16 reports when service providers are involved.

An entity has primary responsibility for assessing and monitoring controls, and should use other sources as a supplement – not a replacement for its judgment.

IDENTIFY WHO WILL PERFORM THE TESTING

Once the reporting entity has determined what control activities have been assessed by other reviews, in full or in part, management must determine who will perform the remaining tests of control activities.

The entity may evaluate the operating effectiveness based on procedures such as:

- testing of control activities by quality control or internal control organizational units,
- testing of control activities by contractors under the direction of management,
- using service organization reports,
- inspecting evidence of the application of control activities, or
- testing by means of a self-assessment process that might occur as part of management's ongoing monitoring process.

In every case, entities must take responsibility for the work including determining whether:

1. Personnel who perform the work have the necessary competence and objectivity, (i.e., personnel performing the test should not be the person responsible for performing the control activity or report directly to the person performing the control activity), and
2. Procedures provide evidence sufficient to support management's assertion and annual Internal Controls over Financial Reporting (ICFR) Statement of Assurance (SOA) memorandum¹⁹.

D.2.3 Execute Tests of Controls (Activity 1.3.3)

Reporting entities and service providers should develop formal test plans to facilitate review and approval of test procedures and results by interested parties. Refer to the FIAR Guidance website for an example of a completed [test plan](#). **The execution of the test plans should include the consideration of the nature, extent (including sampling technique), and timing of the execution of the controls tests.**

NATURE OF TESTS

Tests can be classified into four categories: inquiry, observation, inspection, and re- performance. These categories are described below:

- Inquiry tests are conducted by making either oral or written inquiries of entity personnel involved in the execution of specific control activities to determine what they do or how they perform a specific control activity. The inquiries are typically open-ended. Evidence obtained through inquiry is the least reliable evidence and should be supplemented with other types of control tests (observation or inspection). Inquiry regarding a control's effectiveness does not, by itself, provide sufficient evidence

¹⁸ OMB Circular A-123, Appendix A, p. 13, references the PART. The PART has subsequently been replaced by the reporting requirements under ARRA.

¹⁹ Derived from PCAOB AS 5.

about whether a control activity is operating effectively. The reliability of evidence obtained from inquiry depends on factors such as:

- The competence, experience, knowledge, independence, and integrity of the person of whom the inquiry was made – evidential reliability is enhanced when the person possesses these attributes,
 - Whether the evidence was general or specific – specific evidence is usually more reliable than general,
 - The extent of corroborative evidence obtained – evidence obtained from several entity personnel is usually more reliable than evidence obtained from only one, and
 - Whether the evidence was provided orally or in writing – evidence provided in writing is generally more reliable than evidence provided orally²⁰.
- Observation tests are conducted by observing entity personnel performing control activities in the normal course of their duties. Observation generally provides highly reliable evidence that a control activity is properly applied during the period of observation; however, it provides no evidence that the control was in operation at any other time. Consequently, observation tests should be supplemented by corroborative evidence obtained from other tests (such as inquiry and inspection) about the operation of control activities at other times. However, observation of the control activity provides a higher degree of assurance than inquiries, and may be an acceptable technique for assessing automated controls²¹.
 - Examination of evidence is often used to determine whether manual control activities are being performed. Inspections are conducted by examining documents and records for evidence (such as the existence of initials or signatures) that a control activity was applied to those documents and records. When using examination to perform tests of controls, reporting entities should note the following:
 - System documentation, such as operations manuals, flow charts, and job descriptions, may provide evidence of control design but do not provide evidence that control activities are operating or applied consistently. To use system documentation as evidence of effective control activities, the reporting entity should obtain additional evidence to understand how the control activities were applied.
 - Because documentary evidence generally does not provide evidence concerning how effectively the control was applied, the reporting entity should supplement inspection tests with observation or inquiry of persons applying the control. For example, the reporting entity generally should supplement inspection of initials on documents with observation or inquiry of the individuals who initialed the documents to understand the procedures they followed before initialing²².
 - Re-performance of the control activity is necessary for the entity to obtain sufficient evidence of its operating effectiveness. For example, a signature on a voucher package to indicate approval does not necessarily mean the person carefully reviewed the package before signing. The package may have been signed based on only a cursory review (or without any review). As a result, the quality of the evidence regarding the effective operation of the control might not be sufficiently persuasive. If that is the case, the entity should re-perform the control (by checking prices, extensions, and additions) as part of the test of the control. In addition, entity personnel might inquire of the person responsible for approving voucher packages to understand what he or she looks for when approving packages, and how many errors have been found within voucher packages. Entity personnel also might inquire of supervisors whether they have any knowledge of errors that the person responsible for approving the voucher packages failed to detect. Because entity personnel are re-performing a control, it is not necessary to select high dollar value items for testing or to select different types of transactions.

²⁰ Definition adapted from the FAM, Section 350.

²¹ Ibid.

²² Ibid.

Combining two or more of these test techniques provides greater assurance than using only one testing technique. The more significant the account, disclosure, or process and the greater the risk, the more important it is to ensure the evidence extends beyond one testing technique. The nature of the control also influences the nature of the tests of controls. Most manual control activities are tested through a combination of inquiry, observation, examination, or re-performance. This is illustrated in **Figure 4**.



Figure 4. Relative Level of Assurance by Nature of Test

EXTENT OF TESTING

The extent of testing of a control activity will vary depending on a variety of factors, including whether a control activity is automated or manual.

Testing of Automated Control Activities

For an automated control activity, the number of items tested can be minimal (one to a few items), assuming ITGCs have been tested and found to be operating effectively. A common example of an automated control is an edit check activated during data entry. If a request is entered to pay an individual, the timekeeping and/or payroll system(s) would check to see if an SSN exists for the employee before processing the transaction. If the SSN is not in the system, an error message will be displayed and the pay request will not be processed. Each attribute of the automated control activity must be tested for design effectiveness and if determined to be designed effectively, the control activity will then need to be tested for operating effectiveness. In this example, a baseline understanding should be obtained that will determine whether the edit check controls are designed effectively to work under all circumstances. If the control activity is effectively designed, then the operating effectiveness should be tested by entering a few different invalid entries. In some cases, management override procedures may allow an automated control activity to be circumvented. The override capability should be evaluated to assess potential internal control deficiencies.

When testing automated controls, the reporting entity or service provider: (1) ensures ITGCs are effective and (2) performs a detailed review of the control activities within the computer applications (e.g., a pre-implementation or a post-implementation review). It is management's responsibility to ensure that the automated control activities are working as designed and that there are alternative methods that may be used to accomplish this objective, such as reviewing program code, performing walkthroughs of transactions, observing and confirming that all relevant transaction types and error conditions are covered, etc. For third-party software solutions (e.g., enterprise resource planning systems), the entity should validate that the solution has been configured to include expected automated controls and there is a control process over future changes to configurable parameters. For custom-developed or in-house applications, more extensive procedures may be required to validate the design of the control activity. However, if independent verification and validation (IV&V) testing of changes have been performed for custom- or in-house developed programs, management should evaluate the level of reliance, if any, that can be placed on these procedures.

Testing of Manual Control Activities

Tests of manual control activities (control activities performed manually, not by computer) should include a mix of inquiry, observation, examination, or re-performance. Inquiry alone does not provide sufficient evidence to support the control activity's operating effectiveness. Effective testing generally requires examining the application of a control activity at a particular location many times (referred to as "sampling"). Inherent to sampling is the risk that the control is not operating effectively at all times, although the entity may find nothing amiss in the samples (resulting in a conclusion that a control is operating effectively). Sampling risk should be minimized by selecting a sufficient number of items to test

(e.g., using either statistical or judgmental sampling). Sampling risk increases with the frequency of the control's execution.

The CFO Council, Implementation Guide for OMB Circular A-123, Appendix A provides guidance for determining sample sizes, based on the frequency of a control activity, that will support a conclusion that a manual control activity is operating effectively. The CFO Council's guidance has been included in **Figure 5** along with an acceptable number of deviations that reporting entities can use only for audit readiness purposes (last column). The Department has determined that for certain sample sizes, a larger number of deviations from that accepted by the CFO Council's guidance will be acceptable for audit readiness purposes. However, Management must accept the implications of sampling risk and understand that testing under a financial statement audit will be more rigorous and allow fewer deviations. Entities must document the justification of the sample size used for testing if it differs from the guidance provided in **Figure 5**.

Frequency	Population Size	Total Sample Size	Acceptable Number of Deviations/Tolerable Misstatement (CFO Council)*	Acceptable Number of Deviations/Tolerable Misstatement (Audit Readiness Guidance)
Annual	1	1	0	0
Quarterly	4	2	0	0
Monthly	12	3	0	0
Weekly	52	10	0	1
Daily	250	30	0	3
Multiple Times per day	Over 250	45	0	5

*Represent number of deviations to most likely be used by an auditor when performing an audit.

Figure 5. Frequency of Control Activity Determines Sample Size.

For control activities that occur many times each day, the sample size noted on Figure 5 is consistent with the sampling guidance included in the *GAO/PCIE Financial Audit Manual (FAM)*, Section 450, *Sampling Control Tests*, Figure 450.1, Table 1 for populations over 2,000 items. Using this sample size will derive a 90 percent confidence level when zero deviations are identified.

For controls applied many times a day or ad hoc controls that are not over 2,000 items, consistent with guidance included within FAM section 450²³, the entity may consult a statistician (or personnel qualified to perform sample selections and interpret results) to calculate a reduced sample size and to evaluate the results. The effect is generally small unless the sample size per the table is more than 10 percent of the population.

Sampling Technique

Once the sample size has been determined, the entity should identify a sampling technique to select the items to be tested. When applying the FIAR Methodology, the following two sampling techniques are recommended:

- **Random:** Provides a method to ensure that all items in the population have an equal chance of being selected.
- **Haphazard²⁴:** Provides a method for selecting a representative sample without relying on a truly random process. Sample items should be selected without any conscious bias.

The entity should make every effort to use random sampling. To select a random sample, the entity can use random number tables, random numbers generated in software such as Microsoft Excel, or

²³ Refer to FAM, Section 450, footnote 2

²⁴ A haphazard sample is a sample consisting of sampling units selected without conscious bias, that is, without any special reason for including or excluding items from the sample. It does not consist of sampling units selected in an arbitrary manner; rather it is selected in a way the auditor expects to be representative of the population.

random selection offered by sampling software. When using haphazard selection, be careful to avoid distorting the group of transactions picked for testing by purposely selecting certain types of transactions, such as unusual or large dollar transactions.

Consideration of Locations

When selecting a sample, consideration should be given to the location of the control activity (where the control activity is in place), and how the control activity is implemented. The Statement to Process Analysis (Activity 1.1) performed during the *Discovery Phase* should assist the reporting entity in determining which location should be included within the sample based on quantitative and qualitative considerations (i.e., individually important locations).

Where control activities are implemented across many locations in a standardized manner and are routine in nature, the entity should consider selecting one sample across all of the individually important locations. However, if the reporting entity determines that control activities in place to meet an assessable unit's **FRD** differ at each location or the method of implementation differs at each important location, separate samples should be selected for each location.

TIMING OF PROCEDURES

The time period over which the entity tests its control activities must be sufficient to determine operating effectiveness as of the date of the assertions, (i.e., audit readiness assertion when applicable and/or ICOFR SOA). Perform testing in increments throughout the period being asserted. **The period tested must be sufficient to enable the entity to obtain adequate evidence about the control activities' operating effectiveness.** At a minimum, to make an assertion, the entity must have performed enough tests of control activities to meet the minimum sample sizes noted in **Figure 5**, (e.g., for a monthly control, at least three months be tested for the entity to be able to conclude on the operating effectiveness of its control activity).

Various techniques are available to spread testing across a period. If attempting to obtain evidence of the effectiveness of control activities over a fiscal year, one method is to assess the sample over several quarters. For example, to reach a desired sample quantity of 45, the entity could test 15 instances in each of the first three quarters of the year.

Consideration of Timing for Entities in Sustainment

For entities that have achieved audit readiness and are working to sustain their audit ready state for either one, multiple, or all assessable units, (i.e., full scale audit), the expected timing of the assessment should be at least the nine-month period covering October 1 to June 30. An entity may choose to design its assessment to cover the full fiscal year to evaluate whether corrective actions implemented earlier during the fiscal year had the desired effect, and therefore, conclude that the deficiency has been remediated and control activities are working effectively. However, entities should be mindful of the ICOFR SOA annual reporting requirements. Refer to FIAR Guidance Section 2.F for details of reporting requirements.

Testing Remediated Control Activities

If remediated or new control activities have been implemented during the year or there have been significant changes in the design or application of existing internal control activities during the year (e.g., internal control enhancements or changes addressing deficiencies detected during interim or prior year testing), the entity must assess the control activity's design and test operating effectiveness of the remediated or new control activity between the time the new control activities were implemented and the end of the assertion period. This period must be sufficient to enable entity management to obtain adequate evidence to assess the operating effectiveness of the new or remediated control activity. For example, if an entity is asserting audit readiness for control activities over a fiscal year and a new, monthly manual control is implemented in the middle of the fiscal year's last month, entity management will not have sufficient opportunity to assess its operating effectiveness.

D.2.4 Summarize Test Results (Activity 1.3.4)

Once the tests of control activities are complete, the results must be documented. The documentation provides support for the entity's assertions (i.e., audit readiness assertion when applicable

and/or ICOFR SOA); therefore, it might be reviewed by the independent auditor and possibly by the GAO or OMB. Thus, the testing should be sufficiently documented to allow an independent person to understand and re-perform the test. The documentation should describe the items tested (e.g., the title and date of the report, invoice numbers, check numbers), identify the person who performed the testing, and describe the test results. Please refer to the FIAR Guidance website for an example of a [test plan](#) with documented test results.

D.2.5 Identify, Evaluate and Classify Deficiencies (Activity 1.3.5)

If an exception occurs during testing, the entity must evaluate the exception to determine why it occurred. After investigation of the exception, the entity may determine that the control activity is not operating effectively. When an exception occurs in a quarterly, monthly, or weekly control, there is a strong indication that a deficiency exists due to the small populations involved (e.g., four quarters, 12 months, or 52 weeks). Additionally, the existence of compensating controls does not affect whether an internal control deficiency exists. The factors considered when evaluating control deficiencies are *likelihood and magnitude*. These are defined as follows:

- **Likelihood** – Refers to the probability that a control activity, or combination of control activities, could have failed to prevent or detect a misstatement in the financial statements being audited. If it is at least reasonably possible that a misstatement could have occurred because of a missing control activity, or because of the failure of a control activity or combination of control activities, then the likelihood is more than remote. The existence of a design weakness, in and of itself, is sufficient to conclude that there is more than a remote likelihood that the control activity would not have been effective. Remote and reasonably possible are defined as follows:
 - Remote: The chance of the future event or events occurring is slight.
 - Reasonably Possible: The chance of the future event or events occurring is more than remote but less than likely to occur. Therefore, the likelihood of an event is “more than remote” when it is at least reasonably possible.

When attempting to determine the likelihood of a misstatement consider the following:

- The nature of the financial statement accounts, disclosures, and assertions involved;
 - The susceptibility of the related assets or liability to loss or fraud, (i.e., greater susceptibility increases risk);
 - The subjectivity, complexity, or extent of judgment required to determine the amount involved (i.e., greater subjectivity, complexity, or judgment – like that related to an accounting estimate – increases risk);
 - The cause and frequency of known or detected exceptions for the control activity’s operating effectiveness;
 - The interaction or relationship of the control activity with the other control activities, (e.g., the interdependence or redundancy of the control activity);
 - The interaction of the deficiencies; and
 - The possible consequences of the deficiency.
- **Magnitude** – Refers to the extent of the misstatement that could have occurred, or that actually occurred, since misstatements include both potential and actual misstatements. The magnitude of a misstatement may be inconsequential, more than inconsequential but less than material, or material, as follows:
 - A misstatement is inconsequential if a reasonable person would conclude, after considering the possibility of further undetected misstatements, that the misstatement, either individually or when aggregated with other misstatements, would clearly be immaterial to the financial statements. If a reasonable person would not reach such a conclusion regarding a particular misstatement, that misstatement is more than inconsequential.

- The difference between a significant deficiency and a material weakness is the magnitude of the misstatement that could occur because of the failure of the control activity to prevent or detect a misstatement. If the magnitude of the actual or potential misstatement is less than material but more than inconsequential, the control deficiency is a significant deficiency. If the misstatement was material to the financial statements, the control deficiency is a material weakness. In this evaluation, it does not matter if a misstatement did not actually occur; what is relevant is the potential for misstatement.

In attempting to determine the magnitude of a misstatement, the following should be considered:

- The financial statement amounts or total of transactions exposed to the deficiency; and
- The volume of activity in the account balance or class of transactions exposed to the deficiency that has occurred in the current period or is expected to occur in future periods.

Deficiencies range from a control deficiency to significant deficiency to material weaknesses in internal control as defined below²⁵:

- **Control Deficiency** – Exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. Control deficiencies are internal to DoD and not reported externally.
- **Significant Deficiency** – A control deficiency or combination of control deficiencies adversely affecting the ability of DoD to initiate, authorize, record, process, or report external financial data reliably in accordance with Generally Accepted Accounting Principles (GAAP) such that there is a more-than-remote²⁶ likelihood of not preventing or detecting a more- than-inconsequential misstatement of the entity's financial statements (or other significant financial reports). Such deficiencies are internal and not reported externally.
- **Material Weakness** – A significant deficiency, or combination of reportable conditions, resulting in a more-than-remote²⁷ likelihood that a material misstatement of the financial statements (or other significant financial reports) will not be prevented or detected. Material weaknesses and a summary of the Corrective Action Plans (CAPs) are reported in the Agency Financial Report (AFR).

Figure 6 can be used to assess the classification of internal control deficiencies, individually or in the aggregate, after considering compensating control activities.

²⁵ OMB Circular A-123, pp. 18 – 19.

²⁶ The term "remote" is defined in Statement of Federal Financial Accounting Standards (SFFAS) No. 5, Accounting for Liabilities of the Federal Government, as the chance of the future event, or events, occurring is slight.

²⁷ Ibid.

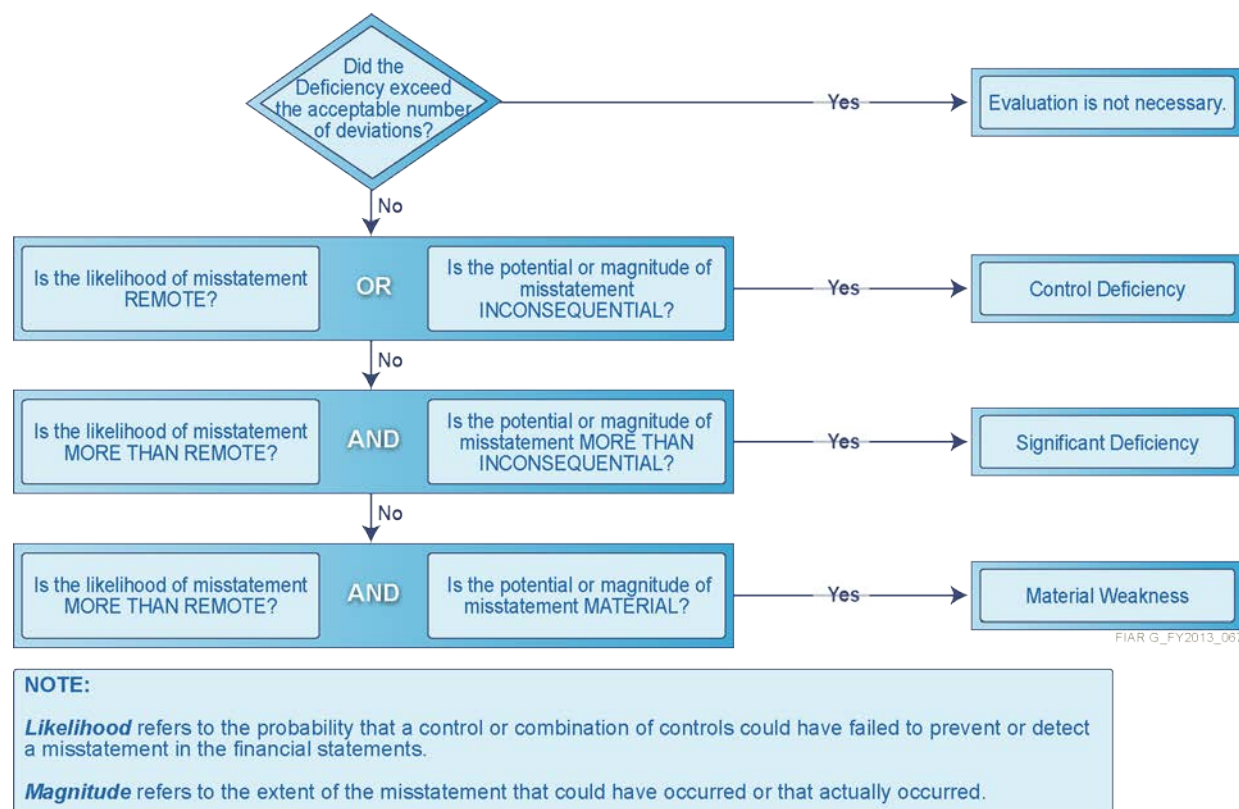


Figure 6. Classification of an Internal Control Deficiency

Aggregation of Deficiencies and Consideration of Compensating Controls

Reporting entities or service providers should first evaluate control deficiencies individually or in combination with other control deficiencies and then decide whether they are significant deficiencies or material weaknesses, after considering the effects of compensating controls. A compensating control is a control activity that limits the severity of a control deficiency and prevents it from rising to the level of a significant deficiency or, in some cases, a material weakness. Compensating control activities can be preventive or detective. Its main objective is to prevent or detect errors that may not be prevented or detected by other control activities. For example, comparison of a receiving report to an approved purchase order allows the reporting entity to prevent the acceptance of an unapproved purchase. This control activity compensates for weaknesses in controls over purchases.

Compensating controls should be tested, documented, and taken into account when assessing the likelihood of a misstatement occurring and not being detected. However, the existence of a compensating control activity does not affect whether a control deficiency exists. If the reporting entity or service provider believes there are compensating controls in place that could address the financial statement assertion or risk resulting from the deficiency, it should consider and validate whether:

- the compensating control activity is effective; and
- the compensating control activity would identify an error and address the assertion.

Since a significant deficiency can be a combination of internal control deficiencies, and a material weakness can be a combination of significant deficiencies, the reporting entity must accumulate all internal control deficiencies for evaluation in the aggregate, considering whether there is a concentration of deficiencies over a particular assessable unit, or financial statement assertion. For example, assume a reporting entity or service provider has three internal control deficiencies in relation to the processing of civilian payroll. Although none of these deficiencies may individually be a significant deficiency, they could potentially rise to the level of a significant deficiency when aggregated together. The assessment of the interaction of deficiencies with each other is essentially a search for patterns (e.g., could the deficiencies

affect the same financial statement accounts and assertions). The reporting entity or service provider should utilize the Summary of Aggregated Deficiency (SAD) Template to assess the likelihood and potential magnitude. Refer to the FIAR Guidance website to obtain the latest version of the [SAD Template](#).

Classification of Internal Control Material Weakness

Internal control material weaknesses previously identified by the reporting entities were classified in the Department's AFR by the financial statement line item or type of activity affected by the material weakness. Beginning in FY 2011, material weaknesses must be classified by the end-to-end business processes affected by the control weakness reported in the AFR. **Therefore, reporting entities must reclassify previously reported material weaknesses based on the end-to-end business processes affected by the material weakness.** Reclassifying the prior year material weaknesses provides a roll-forward in the AFR from the prior year material weakness to the material weaknesses in FY 2011.

Figure 7 provides a summary of the end-to-end business processes and must be used to ensure the classification is consistent among reporting entities.

End-to-End Business Process	Process Description
Budget-to-Report	Budget-to-Report encompasses the business functions necessary to plan, formulate, create, execute, and report on the budget and business activities of the entity. It includes updates to the general ledger. It also includes all activities associated with generating and managing the internal and external financial reporting requirements of the entity, including pre- and post-closing entries related to adjustments, reconciliations, consolidations/eliminations, etc.
Hire-to-Retire	Hire-to-Retire encompasses the business functions necessary to plan for, hire, develop, assign, sustain, and separate personnel in the Department.
Order-to-Cash	Order-to-Cash encompasses the business functions necessary to accept and process customer orders for services and/or inventory. This includes such functions as managing customers, accepting orders, prioritizing and fulfilling orders, performing distribution, managing receivables, and managing cash collections.
Procure-to-Pay	Procure-to-Pay encompasses the business functions necessary to obtain goods and services. This includes such functions as requirements identification, sourcing, contract management, purchasing, payment management, and receipt and debt management.
Acquire-to-Retire	Acquire-to-Retire encompasses the business functions necessary to obtain, manage, and dispose of accountable and reportable property (capitalized and non-capitalized assets) through their entire life-cycle. It includes such functions such as requirements identification, sourcing, contract management, purchasing, payment management, general property, plant & equipment management, and retirement.
Plan-to-Stock	Plan-to-Stock encompasses the business functions necessary to plan, procure, produce, inventory, and stock materials used both in operations and maintenance (O&M) as well as for sale.

Figure 7. DoD End-to-End Business Processes

Please refer to FIAR Guidance website for more guidance related to the [classification of previously reported material weaknesses and identification of OSD Senior Accountability Officials](#).

D.3 SUPPORTING DOCUMENTATION TESTING (ACTIVITY 1.4.5)

In addition to performing tests of internal control activities, reporting entities must perform tests to assess whether appropriate supporting documentation exists and is readily available to support transactions and balances. When possible and effective, reporting entities are encouraged to select dual-purpose samples, whereby documentation demonstrating the effectiveness of internal control activities and supporting transactions and balances can be addressed with one sample. For example, a sample of invoices is selected and reviewed to determine whether the invoices:

- contain evidence of review/approval control, and
- support a transaction selected from the population.

Reporting entities may utilize a variety of sampling techniques to efficiently and effectively form conclusions about the entire population of transactions. Sampling techniques may be non-statistical or statistical. Non-statistical sampling is the Department's preferred sampling technique method. Non-statistical techniques for selecting samples of transactions for supporting documentation testing include:

1. Selecting a random sample from the entire population, and
2. Stratifying the population and then selecting random samples from each strata (useful to ensure higher-risk transactions are isolated, tested and concluded upon separate from the general population).

The Department's non-statistical sampling size guidance has been included in **Figure 8** along with an acceptable number of deviations that reporting entities can use only for audit readiness purposes (last column). The Department has determined that for certain sample sizes, a larger number of deviations from that accepted by the CFO Council's guidance will be acceptable for audit readiness purposes. However, Management must accept the implications of sampling risk and understand that testing under a financial statement audit will be more rigorous and allow fewer deviations. Entities must document the justification of the sample size used for testing if it differs from the guidance provided below.

Acceptable Number of Population Size	Total Sample Size	Deviations/Tolerable Misstatement*	Acceptable Number of Deviation/Tolerable Misstatement (Audit Readiness)
200 or More	55	0	5
100-199	44	0	4
50-99	22	0	2
20-49	11	0	1
Less than 20	5	0	0

*Represents number of deviations to most likely be used by an auditor when performing an audit.

Figure 8. Population Size Determines Sample Size

If the errors exceed the acceptable number of deviations, the reporting entities must design and implement corrective actions to remediate the documentation deficiency and then re- perform additional testing.

While non-statistical sampling is the preferred approach for testing transactions and/or population attributes, statistical sampling can be used when deemed more effective. Statistical sampling helps management (a) to design an efficient sample, (b) to measure the sufficiency of the audit evidence obtained, and (c) to evaluate the sample results and extrapolate the results to the population. By using statistical theory, management can quantify sampling risk to assist in limiting it to an acceptable level.

If considering the use of a statistical sample within its evaluation, the reporting entity must engage a statistician or other personnel qualified to perform the sample selection and interpret the results.

When using statistical sampling for audit readiness purposes, entities must design samples to provide a minimum level of assurance of 86 percent, consistent with a moderate risk of misstatement per FAM Table 470.1. However, management must be aware of the implications of sampling risks associated with deriving sample sizes using a moderate risk of misstatement and

understand that testing under a financial statement audit will be more rigorous as external auditors will strive to obtain a higher level of assurance (typically 95 percent).

When the testing of statistical samples is complete, reporting entities should extrapolate the results to the entire population. Reporting entities should then compare the estimated error to the materiality threshold. If the error is less than the materiality threshold, the reporting entities should consider the transactions or balances to be adequately supported. If the error is greater than the materiality threshold, the reporting entities must design and implement corrective actions to remediate the documentation deficiency, and perform additional procedures to verify that the corrective actions successfully remediated the deficiency.

Regardless of the sampling technique utilized, reporting entities must ensure that:

- 1. The sampling technique, sample sizes, and tolerable errors are defined before selecting the sample,**
- 2. All items in the population have an equal chance of being selected (through the use of random sampling), and**
- 3. Samples are representative of the population; therefore, no material transactions or groups of transactions are excluded from the population.**

When this testing is completed, as part of FIAR Methodology step 1.4.5, reporting entities must retain testing documentation to allow for review during the Assertion / Evaluation Phase.

D.4 DOCUMENT RETENTION REQUIREMENTS

Document retention requirements applicable to Federal entities are included in the U.S. Code Title 44 and the National Archives and Records Administration (NARA) General Record Schedules. The Department has also developed supplementary guidance in DoDI 5015.2 and in the DoD FMR Volume 1, Chapter 9 – Financial Records Retention. However, these requirements do not emphasize the retention requirements of documents necessary to assert and support audit readiness.

As previously discussed, auditors performing government financial statement audits in the United States must adhere to professional standards, which have been codified as Auditing Standards (AUs). These AUs do not directly contain document retention requirements. Instead, they define evidential matter (i.e., supporting documentation) that auditors must obtain and test to form an opinion on the entity's financial statements.

Specifically, AU326 Audit Evidence paragraph .04 notes "... management is responsible for the preparation of the financial statements based on the accounting records of the entity. The auditor should obtain audit evidence by testing the accounting records, for example, through analysis and review, re-performing procedures followed in the financial reporting process and reconciling related types and applications of the same information." In paragraph .02, AU326 defines the term audit evidence as "... all information used by the auditor in arriving at the conclusions on which the audit opinion is based and includes the information contained in the accounting records underlying the financial statements and other information." Accounting records, per AU326 paragraph .03, generally include "... the records of initial entries and supporting records, such as checks and records of electronic fund transfers, invoices, contracts, the general and subsidiary ledgers, journal entries, and other adjustments to the financial statements that are not reflected in formal journal entries, and records such as worksheets and spreadsheet supporting cost allocations, computations, reconciliations, and disclosures."

Accordingly, the document retention requirements to achieve auditability and reliable financial information are sometimes different and more stringent (longer duration) than the requirements set forth by the NARA General Records, the DoD Directives, and reporting entity- specific requirements. The retention requirements for auditability may be less stringent in some cases; therefore, reporting entities must apply to the most stringent record retention requirement.

APPENDIX E – OMB CIRCULAR A-123, APPENDIX A CROSSWALK TO FIAR GUIDANCE

The following crosswalk demonstrates how the FIAR Guidance aligns with the requirements of OMB Circular A-123, Appendix A.

OMB Circular A-123, Appendix A	FIAR Guidance
I. SCOPE	
A. Objectives of Internal Control over Financial Reporting	Section 1.B Purpose of the FIAR Methodology
B. Definition of Financial Reporting	Section 1.A FIAR Priorities and Strategy
C. Planning Materiality	Appendix A , Material Reporting Entities
D. Definition of Deficiencies	Appendix D , Section D.2.5 Identify, Evaluate and Classify Deficiencies
II. ASSESSING INTERNAL CONTROL OVER FINANCIAL REPORTING	
A. Establish a Senior Assessment Team	Appendix B , Section B.1.8 Reporting Entities' Senior Assessment Teams
B. Evaluate Internal Control at the Entity Level	Appendix D , Section D.1 Assessment of Entity-Level Controls
1. Control Environment	Appendix D , Section D.1 Assessment of Entity-Level Controls
2. Risk Assessment	Appendix D , Section D.1 Assessment of Entity-Level Controls
3. Control Activities	Appendix D , Section D.1 Assessment of Entity-Level Controls
4. Information and Communication	Appendix D , Section D.1 Assessment of Entity-Level Controls
5. Monitoring	Appendix D , Section D.1 Assessment of Entity-Level Controls
C. Evaluate Internal Control at the Process, Transaction, or Application Level	Section 3.A.1 Phases and Key Tasks, Discovery Phase, and Appendix D , Section D.2 Assessable Unit Internal Control Testing and Evaluation of Deficiencies
1. Determine Significant Accounts or Groups of Accounts	Section 3.A.5, Detailed Activities, Discovery – Statement to Process Analysis and Prioritization, Tasks 1.1 and 1.2
2. Identify and Evaluate the Major Classes of Transactions	Section 3.A.5, Detailed Activities, Discovery – Prioritization, Task 1.2.
3. Understand the Financial Reporting Process	Section 3.A.5, Detailed Activities, Discovery-Prioritize, Task 1.2.4. Identify Financial Reporting Objectives and Section 3.A.5, Detailed Activities, Assess & Test Controls, Task 1.3
4. Gain an Understanding of Control Design to Achieve Management's Assertions	Section 3.A.5, Detailed Activities, Discovery-Prioritize, Task 1.2.4. Identify Financial Reporting Objectives and Section 3.A.5, Detailed Activities, Discovery-Assess & Test Controls, Tasks 1.3.1 Prepare Process and Systems Documentation
5. Controls Not Adequately Designed	Section 3.A.5, Discovery-Assess & Test Controls, Tasks 1.3.2. Prepare Internal Controls Assessment
6. Test Controls and Assess Compliance to Support Management's Assertions	Section 3.A.5, Discovery-Assess & Test Controls, Tasks 1.3.3. Execute Tests of Controls, and Appendix D , Section D.2 Assessable Unit Internal Control Testing & Evaluation of Deficiencies

OMB Circular A-123, Appendix A	FIAR Guidance
D. Overall Assessment of the Design and Operation of Internal Control over Financial Reporting	Section 2.F.1 Additional Reporting Requirements and Appendix D , Section D.2 Assessable Unit Internal Control Testing & Evaluation of Deficiencies
E. Reliance on Other Work to Accomplish Assessment	Appendix D , Section D.2.2 Prepare Control Assessment, Avoid Duplication of Efforts with Other Similar Activities
III. DOCUMENTATION	
A. Documenting Internal Control over Financial Reporting	Section 3.A.5, Discovery-Assess & Test Controls, Task 1.3.1, Prepare Process and Systems Documentation
B. Documenting the Assessment of Effectiveness	Section 3.A.5, Discovery-Assess & Test Controls, Task 1.3.5, Identify, Evaluate and Classify Deficiencies
IV. MANAGEMENT'S ASSURANCE STATEMENT ON INTERNAL CONTROL OVER FINANCIAL REPORTING	
IV. Management's Assurance Statement on Internal Control over Financial Reporting	Section 2.F.1 Additional Reporting Requirements and Section 3.A.5, Discovery-Assess & Test Controls, Task 1.3.6, Submit Annual ICOFR SOA and Material Weakness CAP Summary
A. Agencies Obtaining Audit Opinions on Internal Control	N/A
V. CORRECTING MATERIAL WEAKNESSES IN INTERNAL CONTROL OVER FINANCIAL REPORTING	
V. Correcting Material Weaknesses in Internal Control over Financial Reporting	Section 3.A.1 Phases and Key Tasks, Corrective Action
Exhibit 2: Sample Annual Assurance Statement on Internal Control over Financial Reporting	
Sample Annual Assurance Statement	Section 2.F.1 Additional Reporting Requirements.

APPENDIX F – ACRONYM LIST

Acronym	Definition
A&FP	Accounting and Finance Policy
AFR	Annual Financial Report
AICPA	American Institute of Certified Public Accountants
AMC	Army Materiel Command
AP	Accounts Payable
APSR	Accountable Property System of Record
AR	Accounts Receivable
ARRA	American Recovery and Reinvestment Act of 2009
ASD	Assistant Secretary of Defense
AT&L	Acquisition, Technology and Logistics
AU	Auditing Standards
BEA	Business Enterprise Architecture
BIO	Business Integration Office
BTA	Business Transformation Agency
CAGE	Commercial and Government Entity Code
CAP	Corrective Action Plan
CFO	Chief Financial Officer
CIIC	Controlled Inventory Item Code
CMO	Chief Management Officer
DCFO	Deputy Chief Financial Officer
DCPS	Defense Civilian Pay System
DFAS	Defense Finance and Accounting Service
DIACAP	DoD Information Assurance Certification and Accreditation Process
DLA	Defense Logistics Agency
DoD	Department of Defense
DoD OIG	Department of Defense Office of Inspector General
DoDAAC	Department of Defense Activity Address Code
DoDI	Department of Defense Instruction
DPAS	Defense Property Accountability System
DUSD	Deputy Under Secretary of Defense
E&C	Existence and Completeness
ERP	Enterprise Resource Planning
ESOH	Environmental, Safety and Occupational Health
ETP	Enterprise Transition Plan
FAD	Funding Authorization Documents
FAM	Financial Audit Manual
FASAB	Federal Accounting Standards Advisory Board
FBWT	Fund Balance with Treasury
FFMIA	Federal Financial Managers' Improvement Act
FIAR	Financial Improvement and Audit Readiness
FIAR-PT	Financial Improvement and Audit Readiness- Planning Tool
FIE	Financial Improvement Element
FIP	Financial Improvement Plan
FISCAM	Federal Information System Controls Audit Manual
FMFIA	Federal Management Financial Integrity Act
FMR	Financial Management Regulation
FMS	Financial Management Service
FRO	Financial Reporting Objective
FY	Fiscal Year
GAGAS	Generally Accepted Government Auditing Standards
GAO	Government Accountability Office
GE	General Equipment
GF	General Fund
GMRA	Government Management Reform Act

Acronym	Definition
GWA	Government-wide Accounting
HC	Human Capital
I&E	Installations and Environment
ICOFR	Internal Control over Financial Reporting
INV	Inventory
IPA	Independent Public Accountant
IPAC	Intra-governmental Payment and Collection
IRB	Institutional Review Board
ITCG	Information Technology General Controls
KSD	Key Supporting Document
LM&R	Logistics & Materiel Readiness
LSN	Local Stock Number
MDAP	Major Defense Acquisition Program
ME	Military Equipment
MIPR	Military Interdepartmental Purchase Request
MOU	Memorandum of Understanding
NARA	National Archives and Records Administration
NAVFAC	Naval Facilities Engineering Command
NDAA	National Defense Authorization Act
NSN	National Stock Number
ODCMO	Office of the Deputy Chief Management Officer
ODO	Other Defense Organizations
OM&S	Operating Material & Supplies
OMB	Office of Management and Budget
OUSD(C)	Office of the Under Secretary of Defense (Comptroller)
PCIE	President's Council on Integrity and Efficiency
PEP	Property & Equipment Policy Office
PMO	Project Management Office
POAM	Plan of Actions and Milestones
PP&E	Property, Plant & Equipment
REMIS	Reliability and Maintainability Information System
RFP	Request For Proposal
RIC	Routing Identifier Code
RMD	Resource Management Decision
RP	Real Property
RPUID	Real Property Unique Identifier
RSI	Required Supplementary Information
RSSI	Required Supplementary Stewardship Information
SAS	Statement on Auditing Standards
SAT	Senior Assessment Team
SBR	Statement of Budgetary Resources
SFFAS	Statement of Federal Financial Accounting Standards
SLA	Service Level Agreement
SMP	Strategic Management Plan
SOA	Statement of Assurance
SSAE	Statements on Standards for Attestation Engagements
SSN	Social Security Number
STANFINS	Standard Financial System
U.S.	United States
UDO	Undelivered Order
UFCO	Unfilled Customer Order
USACE	U.S. Army Corps of Engineers
USD(C)	Under Secretary of Defense (Comptroller)
USMC	United States Marine Corps
WCF	Working Capital Fund

APPENDIX G – GLOSSARY

Auditability – Management's ability to assert that its financial statements, a financial statement line item, or a process/sub-process has sufficient control activities and adequate documentation to undergo an examination or a financial statement audit by an independent auditor and obtain an opinion from the independent auditor, stating that the aforementioned items are free of material misstatement.

Financial Statement Assertions – Management representations that are embodied in transactions. The financial statement assertions can be either explicit or implicit and can be classified into the following broad categories:

Existence and Occurrence: Recorded transactions and events occurred during the given period, are properly classified, and pertain to the entity. An entity's assets, liabilities, and net position exist at a given date.

Completeness: All transactions and events that should have been recorded are recorded in the proper period. All assets, liabilities, and net position that should have been recorded have been recorded in the proper period and properly included in the financial statements.

Rights and obligations: The entity holds or controls the rights to assets, and liabilities are the obligations of the entity at a given date.

Accuracy/valuation or allocation: Amounts and other data relating to recorded transactions and events have been recorded appropriately. Assets, liabilities, and net position are included in the financial statements at appropriate amounts, and any resulting valuation or allocation adjustments are properly recorded. Financial and other information is disclosed fairly and at appropriate amounts.

Presentation and Disclosure: The financial and other information in the financial statements is appropriately presented and described and disclosures are clearly expressed. All disclosures that should have been included in the financial statements have been included. Disclosed events and transactions have occurred and pertain to the entity.

Assertion Documentation – Documentation that demonstrates the reporting entity has designed and implemented an appropriate combination of control activities and supporting documentation to limit the risk of material misstatements by meeting the **Financial Reporting Objectives**. **The documentation is prepared throughout execution of the Discovery and Corrective Action phases of the FIAR Methodology and submitted in accordance with the reporting entities' FIP milestone dates.** FIAR reviews the documentation to determine whether an assessable unit and/or financial statement is audit-ready.

CAGE Code – The CAGE Code is a five position code that identifies contractors doing business with the Federal Government, NATO member nations, and other foreign governments. The CAGE Code is used to support a variety of mechanized systems throughout the government and provides for a standardized method of identifying a given facility at a specific location. CAGE code system is administered by the Defense Logistics Information Service (DLIS).

Corrective Action Plan – A written document that spells out the specific steps a reporting entity will take to resolve a deficiency in its internal control, including targeted milestones and completion dates. Also referred to as a remediation plan, this plan is a result of following the requirements of OMB Circular A-123, Appendix A. Integrate your corrective action plans into your entity Financial Improvement Plan (FIP).

Deficiency – A deficiency that exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements in a timely manner.

Department of Defense Activity Address Code – A six position code that uniquely identifies a unit, activity, or organization that has the authority to requisition and/or receive material. The first position designates the particular Service/Agency element of ownership. These codes are particularly important for Defense Department financial, contracting and auditing records.

Enterprise Transition Plan – A plan that organizes and prioritizes efforts to modernize DoD business, financial processes, systems, and tracks the transformation strategy to achieve the business architecture of the BTA.

Examination – An attestation engagement performed by auditors that consists of obtaining sufficient, appropriate evidence to express an opinion, in accordance with Generally Accepted Government Auditing Standards (GAGAS), on whether the subject matter is based on (or in conformity with) the criteria in all material respects, or the assertion is presented (or fairly stated), in all material respects, based on the criteria.

Executive Agents – The head of a DoD reporting entity to whom the Secretary of Defense or the Deputy Secretary of Defense has assigned specific responsibilities, functions, and authorities to provide defined levels of support for operations missions, or administrative or other designated activities that involve two or more of the DoD reporting entities.

FIAR Governance Structure – A top-down view of financial improvement and audit readiness, which includes roles and stakeholders, and provides the vision and oversight necessary to align financial improvement and audit readiness efforts across the department.

FIAR Guidance – A document that defines the Department's goals, strategy and methodology for becoming audit ready, including roles and responsibilities, and processes for reporting entities, service providers and executive agents.

FIAR Methodology – The Business Rules (presently referred to as the FIAR Methodology) including key tasks, underlying detailed activities and resulting work products that all reporting entities should follow to become audit ready.

FIAR Plan – The strategy for improving financial management, prioritizing needs, and identifying dependencies impeding auditability. The FIAR Plan has three goals: 1) provide timely, reliable, accurate, and relevant financial information to decision makers; 2) sustain improvements through an effective internal control program; and 3) produce auditable financial statements. The primary source of the FIAR Plan is the individual FIPs from material reporting entities.

FIAR Plan Status Report – A document published bi-annually that summarizes the current status, at a point in time, of the Department and its reporting entities in executing the FIAR Plan.

FIAR Strategy – The critical path for the Department's audit readiness and financial improvement efforts. The Strategy balances the need to achieve short-term accomplishments with the long-term goal of an unqualified opinion on the Department's financial statements.

Financial Improvement Plans (FIPs) – A standard framework/template that organizes and prioritizes the financial improvement efforts of the reporting entities and aligns to the FIAR Methodology. It provides a consistent, structured approach for measuring auditability progress, allows transparency into the challenges facing DoD, and highlights progress.

Financial Management Information – Information needed to manage the Department's mission critical assets.

Financial Statement Audits – Financial statement audits provide reasonable assurance through an opinion (or disclaim an opinion) about whether an entity's financial statements are presented fairly in all material respects in conformity with U.S. GAAP, or with a comprehensive basis of accounting other than U.S. Generally Accepted Accounting Principles.

Generally Accepted Accounting Principles (GAAP) – Standards, conventions and rules accountants follow in recording and summarizing transactions as well as the preparation of financial statements.

Generally Accepted Auditing Standards (GAAS) – Sets of standards against which the quality of audits is performed and may be judged.

Key Capabilities – Key indicators that demonstrate a reporting entity's audit readiness.

Financial Reporting Objectives (FROs) – Objectives that capture the outcomes needed to achieve proper financial reporting and serve as a point against which the effectiveness of financial controls can be evaluated.

Key Supporting Documents (KSDs) – Documentation retained to demonstrate control activities are properly designed and operate to satisfy KCOs, as well support individual financial transactions and accounting events.

Legacy Assets – In order to effectively remediate new PP&E acquisition processes, reporting entities must begin by identifying the date by which they will be able to establish processes and practices (i.e., adequate systems and internal control practices) for future acquisitions that will capture and sustain transaction based data that meet the historical cost valuation requirements of SFFAS No. 6, *Accounting for Property, Plant, and Equipment*. Assets acquired before that date are considered legacy assets.

Material Reporting Entities – All DoD reporting entities needed to achieve coverage of at least 99 percent of the Department's total Budgetary Resources or assets.

Material Weakness – A deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis (per AU Section 325.06).

Micro-application – computer based tool(s), such as spreadsheets or databases, which generate financial reporting data and operate as key financial controls or processes outside of the security boundaries of a standard financial application.

Mission Critical Assets – Assets deemed necessary to perform the primary missions of the Department. For purposes of this definition, mission critical assets include: Military Equipment (e.g., ships, aircraft, and combat vehicles), Real Property (e.g., land, buildings, structures, and utilities), Inventory (e.g., rations, supplies, spare parts, and fuel), OM&S (e.g., ammunition, munitions, and missiles), and GE (e.g., training equipment, special tooling, and special test equipment).

Mock SSAE 16 Attestation – An alternative approach to undergoing an SSAE 16 attestation, in which similar procedures are applied to the service provider processes to determine whether there are any impediments to obtaining a “clean” SSAE 16 report. A mock SSAE No. 16 will include a description of the service organization's “system” and a written assertion from management of the service organization that fairly presents the service organization's system as designed and implemented throughout the specified period, and that the controls related to the control objectives stated in the description of the “system” for the service organization were suitably designed to achieve the control objectives as of the specified period. However, a mock SSAE No. 16 report will not include an assurance report with an auditor's opinion on management's assertions.

Reporting Entity – An entity or fund within the Department of Defense that prepares stand- alone financial statements included in the DoD Agency-wide financial statements. All reporting entities are working to become audit ready or their financial statements are currently being audited.

Routing Identifier Code (RIC) – Codes assigned by services/agencies for processing inter-service/agency and intra-service/agency logistics transactions. The codes serve multiple purposes in that they are source of supply codes, intersystem routing codes, intra-system routing codes and consignor (shipper) codes.

SSAE 16 attestation – An attestation in accordance with Statement on Standards for Attestation Engagements (SSAE) No. 16, Reporting on Controls at a Service Organization. An SSAE No. 16 report includes the following three sections:

1. A description of the service organization's “system.”
2. A written assertion from management of the service organization that fairly presents the service organization's system as designed and implemented throughout the specified period, and that the controls related to the control objectives stated in the description of the “system” for the service organization were suitably designed to achieve the control objectives as of the specified period.
3. A service auditor's assurance report.

SSAE No. 16 was finalized by the Auditing Standards Board of the AICPA in January 2010 and replaces SAS 70 as the authoritative guidance for reporting on service organizations for reports with an issue date of June 15, 2011 or later.

Service Provider Auditor – The auditor who is retained by the service provider to issue an opinion report on controls of the service provider that may be relevant to a reporting entity's internal control as it relates to an audit of financial statements (e.g., SSAE 16 attestation report).

Service Provider – The entity (or segment of an entity) that provides services to a reporting entity that are part of the reporting entity's manual and/or automated processes for financial reporting.

Significant Deficiency – A deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance (per AU Section 325.07).

Strategic Management Plan – An executive overview of the Department's overall strategic planning and management framework. The National Defense Authorization Act for Fiscal Year 2008 called for a SMP to be issued by the Department of Defense in July 2008. The second SMP, published and delivered to Congress in July 2009, described the integrated activities representing the Department's performance management system. This integration has enabled the Department's leadership to increase productivity by focusing resources on the key levers that drive success. It establishes five high-level priorities for business operations.

User Auditor – The financial statement auditor who issues an opinion report on the financial statements of the reporting entity.